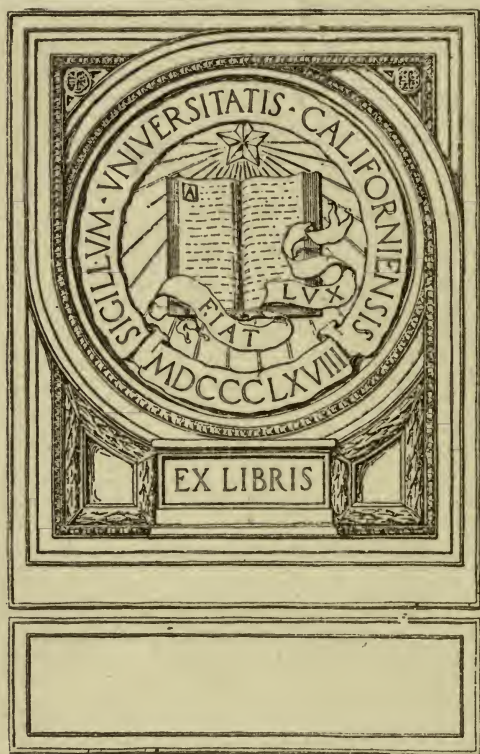


INCOME TAX

Law and Accounting

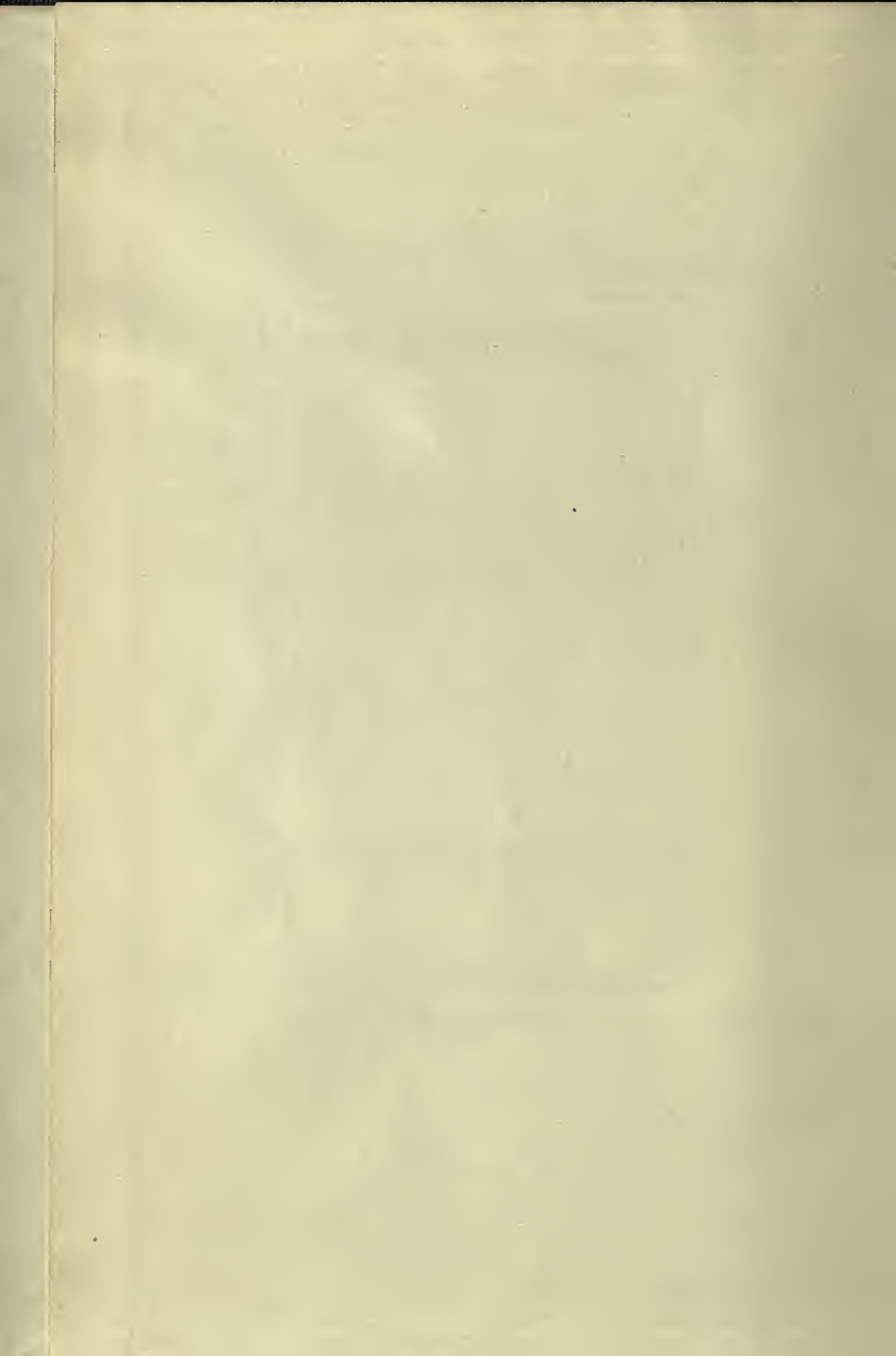
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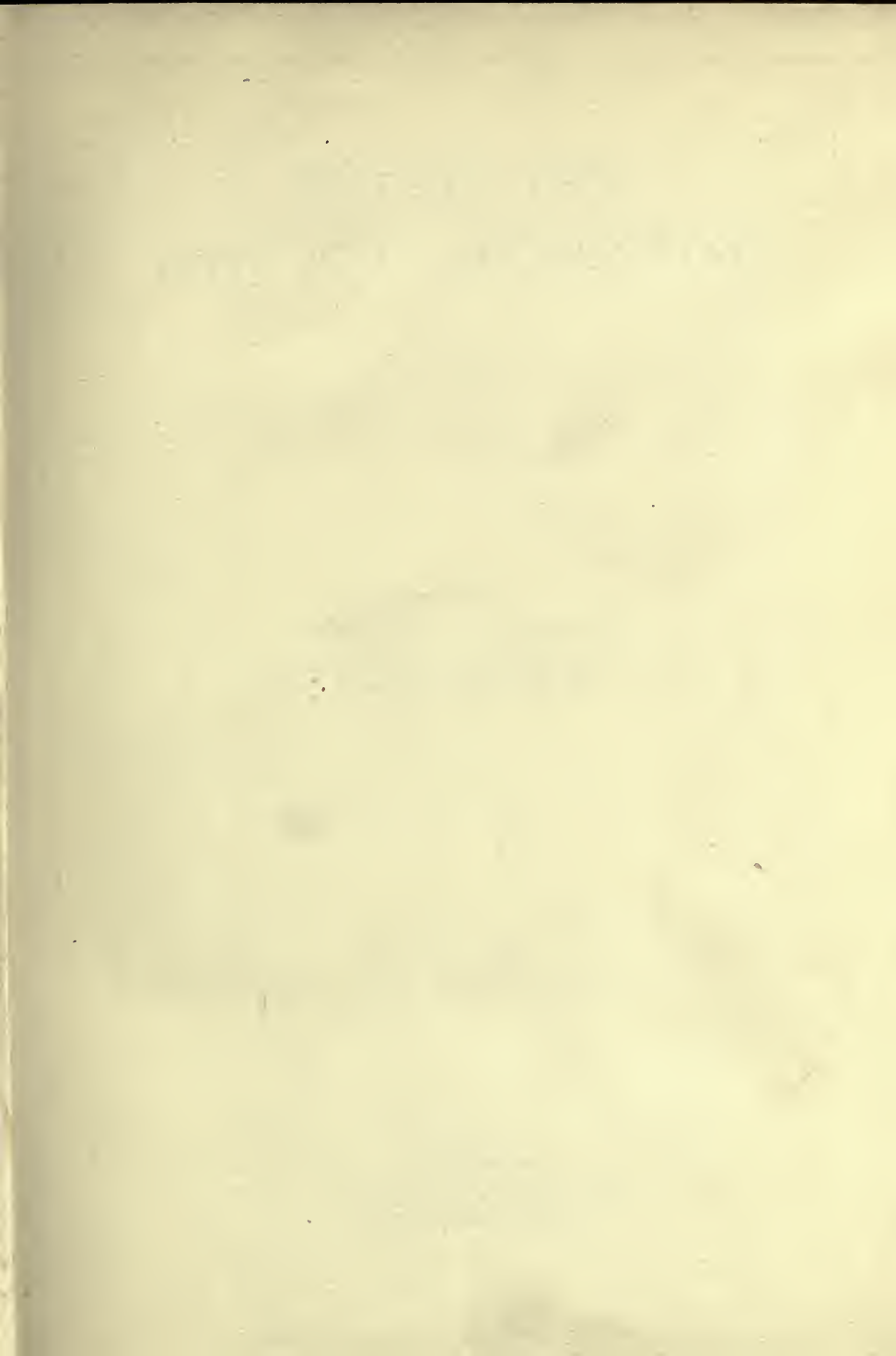
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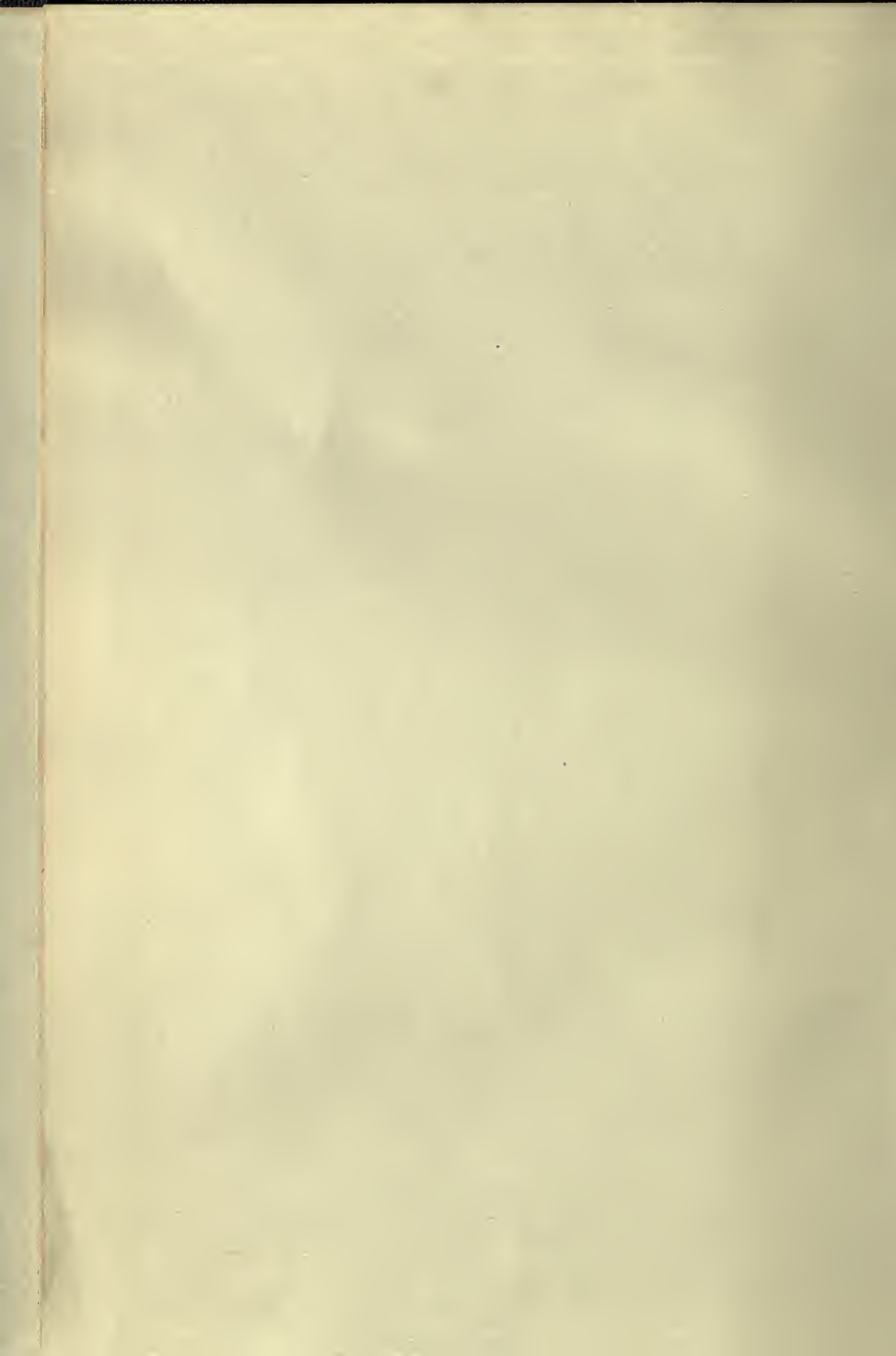




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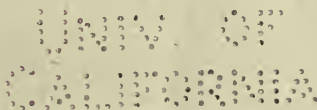


INCOME TAX LAW AND ACCOUNTING

—BY—

GODFREY N. NELSON

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PUBLISHED BY
GODFREY N. NELSON
52 BROADWAY, NEW YORK

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PREFACE

Since the enactment of the Corporation Excise Tax of 1909, and the Federal Income Tax Law, applicable to both individuals and corporations, effective March 1, 1913, the writer has prepared, and advised with regard to, many income tax returns of corporations and individuals. The preparation of returns almost invariably necessitated the analysis and subdivision of book accounts as commonly kept in order to conform them to the classification prescribed by these laws. To obviate the necessity of analyzing and rearranging accounts and to facilitate the preparation of returns was the first thought that actuated the writing of this book. To make it more helpful there have been included rulings of the Treasury Department and court decisions on the most important items of income and expenses.

The writer makes no pretence at having produced a law book and at no time had that aim in view. This is intended merely to serve the purpose of a practical guide to those who, either for themselves or others, are called upon to prepare returns. Statements contained herein are predicated: first, upon the Income Tax Law enacted September 8, 1916, which was retroactive and took effect as of January 1, 1916; second, upon rulings by the Treasury Department thereon; and third, upon such rulings and court decisions under the Excise Tax of 1909 and the Income Tax Law of 1913, which are consistent and not in conflict with the requirements of the present law.

An expression of gratitude is due to various officials and officers of Internal Revenue of the Treasury Department at Washington and New York for the courtesies shown to the writer in matters submitted to them, but this acknowledgment should not be construed as an endorsement by them of the contents of this book. The writer also acknowledges the helpfulness of the Income Tax Service of the Corporation Trust Company, the index to which was especially useful as a ready reference to Treasury Decisions. Mention should also be made of Mr. Henry Campbell Black's treatise on the law of "Income Taxation" under Federal and State laws, to which the writer has referred.

The arrangement of subjects is not co-ordinate throughout, but the order of the statute and the returns of net income have been followed as nearly as practicable.

GODFREY N. NELSON.

New York City,
December 16th, 1916.

357347

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INCOME TAX—LAW AND ACCOUNTING

CHAPTER I

INCOME TAX AS APPLIED TO INDIVIDUALS

1. GENERAL PROVISIONS

Amended Law

The Federal Income Tax Law was amended by “an act to increase the revenue and for other purposes,” enacted September 8, 1916.

Who is Subject to Tax

Every citizen of the United States, irrespective of his place of residence, at home or abroad, and every resident of the United States, shall pay the tax upon his entire net income received from all sources, in the preceding calendar year; and every non-resident alien shall pay the tax upon his entire net income received from all sources within the United States; less the credits and exemptions to which such persons shall, respectively, be entitled under the law.

Division of Tax

The tax on the income of individuals is composed of two parts, designated the “normal tax” and the “additional tax.”

Normal Tax

The normal tax imposes the fixed annual rate of 2 per cent. upon the entire net income of individuals, except,

1. Income derived from dividends on the capital stock or net earnings of corporations, joint stock companies or associations, or insurance companies, on which the normal tax is paid by such companies or associations.

2. The personal exemption of \$3,000 per annum to the unmarried person and \$1,000 additional to the head of a family, or to a married man with a wife living with him, or to a married woman with a husband living with her, provided, however, that only \$4,000 shall be allowed to both husband and wife from their aggregate income.

Additional
Tax

The additional tax is imposed upon all net income of the individual, including that received as dividends on capital stock or from net earnings of corporations, joint stock companies or associations, or insurance companies, in excess of \$20,000, upon the progressive scale, as follows:

From	\$20,000 to	\$40,000.....	1	per cent.
"	40,000 to	60,000.....	2	" "
"	60,000 to	80,000.....	3	" "
"	80,000 to	100,000.....	4	" "
"	100,000 to	150,000.....	5	" "
"	150,000 to	200,000.....	6	" "
"	200,000 to	250,000.....	7	" "
"	250,000 to	300,000.....	8	" "
"	300,000 to	500,000.....	9	" "
"	500,000 to	1,000,000.....	10	" "
"	1,000,000 to	1,500,000.....	11	" "
"	1,500,000 to	2,000,000.....	12	" "
In Excess of	\$2,000,000.....		13	" "

Tax Year
Beginning
1916

The calendar year comprises the tax year.

The foregoing tax rates, normal and additional, apply to the entire net taxable income received by every person in the calendar year 1916, and every calendar year thereafter.

II. RETURNS OF INDIVIDUALS.

Return

A "return" is the statement or report of income upon which the Government bases the assessment of income tax. The return required of individuals is known as Form 1040, Revised.

Who is
Required to
Make
Returns

Every person having received an income, irrespective of source, of \$3,000 or more, within the year, must make and file a return. The fact that a person's employer withholds the tax and pays the same does not relieve the employee of making an individual return. The same is true of persons whose entire income is in the form of dividends. Or, if the combined income of a person, including salary and dividends, or any other combination of sources, aggregates \$3,000 or more within the year,

the recipient thereof must make and file a return. Persons receiving less than \$3,000 in the year are not required to make a return unless especially demanded by the Commissioner of Internal Revenue.

**No Obligation
Upon
Government
to Send Out
Blanks**

There is no obligation upon the part of the Government to seek out those who are taxable or to send the necessary blank to those of whom a return is required. It is incumbent upon the individual to obtain the blank from the Collector of his district if he is required, under the law, to file a return.

**Return by
Husband and
Wife**

Income of the husband and wife, if not living apart, may be returned in one report.

If the aggregate income of both husband and wife exceeds \$4,000 a return of their combined incomes must be made, even though neither one separately has an income of \$3,000 per annum. When separate returns are made the exemption of \$4,000 may be prorated by agreement between them but the aggregate exemption deducted shall not exceed \$4,000. When the income of husband and wife exceeds \$20,000 per annum, they should make separate returns because the additional or surtax is computed on the separate income of each individual.

**Returns of
Fiduciaries**

All persons and corporations acting in a fiduciary capacity, such as guardians, trustees, executors, administrators, receivers, conservators, must make and render a return of net income of the person, trust or estate for whom or which they act (Form 1041, Revised) and are subject to all the provisions in regard thereto that apply to individuals. Where there is more than one person or corporation acting in a fiduciary capacity, the return of one is sufficient, provided that such return is a complete report upon all income received.

An executor or administrator is required to make a return of the income received by the decedent for the period from the first day of January to the date of the decedent's death. (Form 1040 Revised.)

Agent Acting Under Power of Attorney

A person acting under a power of attorney is not construed to be a fiduciary and is not required to render return of receipts and disbursements in his representative capacity. Should he, however, have title to property, from which there is income, irrespective of actual ownership, he must make return of such income. A property owner cannot conceal his income by assigning it to a representative for the purpose of escaping the tax. Where there is a transfer of vested interest in property the transferee must include in his return not only such part of income as has been paid to the principal but the undistributed portion as well.

Income to Heirs and Legatees

Where the beneficiaries receive regular incomes from an estate, the respective shares to be distributed shall be the amount returnable and subject to the tax.

Form of Return

The return of individuals must be made under oath on the form (1040 Revised) provided by the Government.

Return by Agent

If, by reason of illness, absence or non-residence, a person is unable to render a return in due time, then the return may be made by an agent having knowledge of the affairs of such person whose return he makes. Such agent is subject to all penalties provided for erroneous, false or fraudulent returns.

Citizens Residing Abroad Must Make Return

The fact that an American citizen resides abroad and pays an income tax to the country wherein he resides, does not excuse him from paying an income tax in the United States. He is required to make a return of all his income to the Collector in the district of his legal residence or principal place of business in the United States. If a citizen, residing abroad, has no residence or place of business in the United States, his return should be made to the Collector of Internal Revenue, Baltimore, Maryland.

To Whom
Return is
Made

A true and accurate return of net income must be filed with the Collector of Internal Revenue for the district in which the person has his legal residence or principal place of business, or if there be no legal residence or place of business in the United States, then with the Collector of Internal Revenue, Baltimore, Maryland.

Due Date
of Filing

The return for the year ending Dec. 31, 1916, must be filed on or before March 1, 1917, and the return for each calendar year thereafter must be filed on or before March 1st next succeeding such calendar year.

Extension of
Time to File
Return

In case of inability, occasioned by sickness or business, to file a return in due time (March 1) application for extension of time should be made in writing to the Collector, on or before the day on which the return becomes due, for an extension of time; such extended time cannot exceed thirty days from March 1st except that the Commissioner of Internal Revenue (Washington) has authority to grant a further reasonable extension of time, in meritorious cases, to persons traveling or residing abroad.

Penalty for
Failure to
File Return

Failure to file returns may be due to one of two reasons, or both: delinquency or refusal. In case of mere delinquency, where there is no willful intent to violate the law, it seems that the Collector may accept offers in compromise in lieu of specific penalties imposed by the law. Where, however, there is a refusal or willful intent to violate the law, an offer of compromise will not be accepted in lieu of the specific penalty.

Any person that refuses or neglects to make a return of annual net income, who is subject to a tax by provision of law, is liable, under the law, to a penalty of not less than \$20 nor more than \$1,000.

"In case of any failure to make and file a return or list within the time prescribed by law or by the Collector, the Commissioner of Internal Revenue shall add to the tax 50 per centum of its amount except that, when a return is voluntarily and without notice from

the Collector, filed after such time and it is shown that the failure to file it was due to a reasonable cause, and not to willful neglect, no such addition shall be made to the tax."

**When
Internal
Revenue
Officers May
Prepare
Return**

The Commissioner of Internal Revenue in cases of refusal or neglect to make a return, or in case of an erroneous, false, or fraudulent return having been made, has the right to make a return in behalf of the party taxable at any time within three years after said return is due or has been made, and the assessment made by the Commissioner in such case shall be payable by such person, or persons, immediately upon notification of the amount of such assessment.

**False Return
Penalty**

"Any individual * * * required by law to make, render, sign or verify any return who makes any false or fraudulent return or statement with intent to defeat or evade the assessment required by this title to be made, shall be guilty of a misdemeanor, and shall be fined not exceeding \$2,000 or be imprisoned not exceeding one year, or both, in the discretion of the court, with the costs of prosecution."

**Due Date
of Payment
Penalty for
Delayed
Payment
of Tax**

The Commissioner of Internal Revenue is required, on or before the first day of June of each year, to notify all taxable persons of the amount that they have been assessed. The tax becomes payable on 15th day of June. After ten days' notice by the Collector, there will be added to the unpaid taxes interest at the rate of one per cent. per month from the time that the tax became due and an additional penalty of five per cent. of the amount of the tax.

**Return of
Nonresident
Alien**

In order to obtain the benefit of the personal exemption, a non-resident alien must file, or cause to be filed, a true and accurate return of all income received from all sources within the United States regardless of whether such income is less than \$3,000 in the year. But a non-resident alien is not required to include in his re-

turn income derived from sources without the United States.

**Residence
Defined
Alien**

"Residence" has been held to be "That place where a man has his true, fixed and permanent home and principal establishment, and to which, whenever he is absent, he has the intention of returning; and indicates permanency of occupation as distinct from lodging or boarding, or temporary occupation."

An alien, temporarily residing in the United States or employed therein for a definite time, who has the intention of leaving upon the termination of his employment or mission, is deemed not to be a resident of the United States for purposes of the income tax.

An alien, however, who has his principal place of business, or who is permanently employed in the United States, though his domicile be without the United States, is deemed to be a "person residing in the United States, though not a citizen thereof * * *."

**Claims for
Refund of
Taxes**

Claims for refund of taxes after assessment has been fixed, should be made on Form 46, to which should be attached the receipt for taxes paid sought to be recovered.

Claims for abatement of taxes or penalties must be made on Form 47. Each of these claims must be supported by the affidavit of party aggrieved, and by affidavit of the Collector or Deputy Collector of the district in which the claim is made.

**Claims for
Refund**

**Statute of
Limitations**

The present income tax law provides that claims for the refund of taxes paid under the excise act of August 5, 1909, and the income tax act of October 3, 1913, which have been rejected by reason of the statute of limitation in existence prior to September 8, 1916, may be reopened, provided that such claims for refund involve a review of the return on which the claim is made. This question was ruled upon in T. D.¹ 2396, dated November 1,

¹ "T. D." refers to rulings issued by the Treasury Department at Washington.

1916, containing a letter written to the Collector of Internal Revenue, Los Angeles, California, as follows:

"This office is in receipt of your letter of the 26th ultimo, asking for a ruling as to whether, under section 14, paragraph A, of the act of September 8, 1916, claims for refund which have once been rejected by the commissioner because of the statute of limitation in existence at that time may be reopened. The portion of section 14 referred to is in the following words:

" 'Provided, That upon the examination of any return of income made pursuant to this title, the act of August 5, 1909, * * * and the act of October 3, 1913, * * * if it shall appear that amounts of tax have been paid in excess of those properly due, the taxpayer shall be permitted to present a claim for refund thereof notwithstanding the provisions of section 3228.'

"This office is of the opinion that claims can now be made for refund under that provision. Claims rejected can also be reopened if the question involves an examination of the return. The power does not extend to other claims whose adjustment does not necessitate an examination of the return."

III. INCOME OF INDIVIDUALS.

Income Defined

Income, for the purpose of the tax, comprehends revenue and income from all sources, as follows: gains, profits, salaries and wages received, including income from professions, vocations, business, trade, commerce, sales, dealings in or use of real and personal property, rents, interest, dividends, securities, transactions of any business for gain or profit and income derived from any other source whatsoever.

Undivided Surplus of Corporation

Although the law provides that the taxable income of an individual shall include the share to which he would be entitled as stockholder or otherwise of the gains and profits, if divided or distributed, whether divided or dis-

tributed or not, of all corporations, joint stock companies or associations, or insurance companies, yet it does not impose upon the stockholder the duty of ascertaining his share of an undistributed surplus.

Where a surplus is accumulated beyond the reasonable needs of the business, such unreasonable accumulation shall be *prima facie* evidence of a fraudulent purpose to escape the tax. "But the fact that the gains and profits are, in any case permitted to accumulate and become surplus shall not be construed as evidence of a purpose to escape the said tax in such case unless the Secretary of the Treasury shall certify that in his opinion such accumulation is unreasonable for the purposes of the business. When requested by the Commissioner of Internal Revenue, or any district collector of internal revenue, such corporation, joint stock company or association, or insurance company shall forward to him a correct statement of such gains and profits and the names and addresses of the individuals or shareholders who would be entitled to the same if divided or distributed."

**Dividends of
Life
Insurance
Companies**

Dividends paid by a life insurance company on a policy that has not matured are not taxable as income, whether paid by cash or deducted from current premiums.

Dividends paid on a paid-up policy, however, should be treated the same as stock dividends, free from the normal tax and only taxable when the person receiving the same has an annual income of over \$20,000.

Annuities

"The amount paid under a life insurance, endowment, or annuity contract is not income when returned to the person making the contract, either upon the maturity or surrender of the contract; but the amount by which the sum received exceeds the sum paid and coming into the hands of the person making the contract and payment is income. When the settlement under such a contract is made in more than one payment each pay-

ment will be considered as being composed of interest and a proportionate part of the principal. Where the entire annuity is composed of an interest return upon the principal sum paid therefor, the entire annuity is income." (T. D. 2090.)

**Damages,
Injuries**

Amounts received from a railroad company as reimbursement for expenses occasioned by an accident, are not considered income subject to tax. Amounts received, however, in compromise or settlement of an action for "pain and suffering" is held to be such income as is taxable, as "gains or profits and income derived from any source whatever." (T. D. 2135.)

**Accident
Insurance**

Money received by an injured person under an accident policy of insurance is, for income tax purposes deemed to be income. Payment to a beneficiary, however, of the proceeds of an accident insurance policy, upon death of the insured, is not taxable as income.

Dividends

Corporations pay the tax of 2 per cent. on their entire net income. Hence, dividends paid out of said net earnings are free from the normal tax in the hands of stockholders.

But a person whose entire income is composed of dividends is not absolved from making a return, if the aggregate thereof is \$3,000 or over within the year.

**Dividends
Declared
Payable in
Securities**

Dividends declared payable in securities should be stated in the return of the stockholder at the cash value of such securities. The cash value is measured, primarily, by the amount charged to surplus account on the books of the corporation declaring the dividend. For example, dividends declared payable in Anglo-French bonds at 95, will be returnable by the recipient, for income tax purposes, at the aggregate amount of such bonds received, computed at \$95 on each \$100 of the par value thereof.

Dividends Earned Prior to March 1, 1913	Dividends paid out of earnings of a corporation accrued prior to March 1, 1913, are not subject to the additional or surtax.
Stock Dividends	Stock dividends paid by a corporation are subject to the income tax based on the cash value of such stock.
Cash Value of Stock Dividends	It has been held that the cash value of stock dividends shall be the amount represented by the stock distributed as dividends charged to surplus account, except where part of such surplus has been accrued prior to March 1, 1913. In the latter case the cash value is such of "the proportionate share of the surplus accrued to the paying corporation since March 1, 1913, as is represented by the stock distributed, or ordered to be distributed."
Sales of Stock Rights Income	Sales of "rights" to subscribe to capital stock, accruing to stockholders in the case of new issues, are deemed to be income.
Exchange of Stock	An exchange of one share of stock of a corporation for two shares of stock of another corporation, both having the same par value, does not constitute taxable income until the stock received in exchange is sold; then the profit will be the difference between the selling price and the purchase price of stock first acquired.
Return of Capital to Stockholders	Payments made to stockholders of a liquidated or dissolved corporation as prorata return of capital is not taxable, but any payments out of the surplus of a corporation accrued since March 1, 1913, shall be returned as income.
Interest on Government Obligations Not Taxable	Interest upon the obligations of a State, or any political subdivision thereof, or upon the obligations of the United States or its possessions, or securities issued under the provisions of the Federal farm loan account of July 17, 1916, are exempt, by law, from the income tax.

**Income
Received
by Estates**

"Income received by estates of deceased persons during the period of administration or settlement of the estate, shall be subject to the normal and additional tax and taxed to their estates." This is true also of income from any kind of property held in trust, including that on accumulated income held in trust for the benefit of "unborn or unascertained persons, or persons with contingent interests and income held for future distribution under the terms of the will or trust." In such cases, except where the beneficiary makes the return, the executor, administrator or trustee shall make a return and be assessed on such income, less the exemption allowed to estates during administration.

**Salary Paid
by Stock**

Salary paid in the capital stock of a corporation is taxable as income based on its cash value.

Bonuses

Bonuses received from employers in the nature of additional compensation and not as gratuities are taxable as income of the recipient. (See page 100.)

Salaries

Salaries need not be returned as income until actually received.

**Money
Equivalent**

Any money equivalent received by an employee, in lieu of money compensation, is returnable as income at the value thereof.

Rental Value

Rental value of living quarters furnished to an employee is held to be income and should be included in the return of the individual at the value thereof.

**Income Not
in Trade**

All profits or income whether made "in trade" or otherwise, are taxable income. (See "Deductions," page 26.)

**When
Professional
Fees are
Returnable**

Fees for professional services need not be returned as income until received. Promissory notes, however, received in payment of such fees shall be deemed to be income received.

- Promissory Notes** Where income is computed on the basis of actual receipts and disbursements, a promissory note is deemed payment of an account and is returnable as income. In the event that such note is not paid, it is deductible as a loss when actually ascertained to be worthless.
- Property Acquired by Gift** Property acquired by gift is not taxable, but the income accruing therefrom after receipt of such gift is income and subject to the tax. Property acquired by gift and thereafter sold at an advance of the value when gift was received, yields a profit of the difference between the selling price and such value, that is taxable as income. If such property was acquired prior to March 1, 1913, then the profit will be the difference between the selling price and the fair market value as at March 1, 1913.
- Clergymen** Fees received by clergymen, in addition to salary compensation, for any form of service, are construed to be taxable income.
- Insurance Agents** Commissions received on renewal premiums are taxable income in the year received by the agent. The premium on a policy of insurance received by an insurance agent on account, or in payment of commission, in lieu of cash, is deemed to be income.
- Rents** Rent should be included in the return of the landlord for the year in which it is actually received, irrespective of when it accrued or became due.
- Compensation of Trustee** Compensation received by a trustee covering a period of years and not paid or reported as income until maturity of trust, has been held to be returnable in the year received and deductions therefrom may not be pro-rated over the years of the trusteeship. Only deductions applicable to the year income is returned are allowable.
- Pensions** Pensions received from the United States Government are deemed to be taxable income.

**Profit on
Sales of
Capital Assets**

Profit on the sale of capital assets is returnable as income. The profit on sales of capital assets acquired prior to March 1, 1913, is the excess of the selling price over the fair market price or value of such property as of March 1, 1913. In the case of property acquired since that date the profit is the selling price in excess of the cost. If the capital asset is one on which depreciation has been charged off, it is reasonable to assume that such depreciation should be taken into consideration in determining the profit or loss. For example, a machine purchased on January 1, 1914, for \$1,000 on which depreciation was charged off at the rate of 10 per cent. per annum for years 1914 and 1915, sold on January 1, 1916, for \$850, would show a profit of \$50, derived as follows:

Selling price	\$850 00
Cost	\$1,000 00
Less Depreciation charged off	
(20%)	200 00
	<hr/>
	800 00
	<hr/>
Profit	\$50 00
	<hr/> <hr/>

The law itself makes no mention of depreciation charged off prior to the time of sale, nor has there, as yet, been any ruling on the question. From an accounting point of view, however, there is only one logical conclusion, and that is to deduct whatever depreciation had previously been charged off before determining the profit or loss, provided that repairs and renewals had been charged against revenue and not against the reserve for depreciation. Should repairs have been charged against the reserve, then the cost of such repairs would be a reduction of the depreciation deducted from the cost of the machine in determining amount of profit on the sale. Assuming, in the above example, that repairs and renewals cost \$25, the result would be as follows:

Selling price	\$850 00
Cost	\$1,000 00
Deduct:	
Depreciation charged	
off (20%)	\$200 00
Less Repairs	25 00
	<hr/>
	175 00
	<hr/>
	825 00
	<hr/>
Profit	\$25 00
	<hr/>

Computing
Profit and
Loss on
Property
Acquired
Prior to
March 1, 1913

For the purpose of ascertaining the profit or loss, for income tax purposes, arising in connection with property which was acquired prior to March 1, 1913, the prorating of actual time property has been held should be ascertained in years and months, a fractional part of a month being counted as a whole month when the fraction is fifteen days or more and discarded when the fraction is less than fifteen days. (T. D. 2291.)

Fair Market
Price or
Value of
Securities

In determining the fair market price or value for the purpose of ascertaining the profit or loss on the sale of stocks or bonds acquired prior to March 1, 1913, where such stocks or bonds are dealt in on the exchange, it has been stated by the Commissioner of Internal Revenue in a letter to the Corporation Trust Co., dated November 21, 1916, that such fair market price would be the average price at which such securities sold on March 1, 1913, and not the price at which they sold at any particular time of the day. The acceptability of market quotations is, nevertheless, conditioned upon the same being the "fair market price or value."

Fair Market
Price or Value
as of
March 1,
1916,
Generally

No particular basis or method of computation has been prescribed by which to fix the "fair market price or value" for the purpose of ascertaining the profit or loss on property acquired prior to March 1, 1913. The

price or value of property should be determined upon all the relevant facts governing the particular case.

Profit Defined Profit, for income tax purposes, has been defined as the difference between the selling price and the cost, where the selling price is more than the cost.

IV. DEDUCTIONS ALLOWED TO INDIVIDUALS.

Specific Exemption The specific or personal exemptions, deductible under the amended law, as compared with those under the old income tax law, have been liberally extended. They are as follows:

Unmarried person	\$3,000	per annum
Married person, living with husband or wife	4,000	" "
Head of family.....	4,000	" "
Nonresident alien (obtainable only by filing true and accurate return):		
Single person	3,000	" "
Married person	4,000	" "
Estate of deceased person during period of administration.....	3,000	" "

The single or married status of a person at the close of the year determines the amount of the specific exemption.

Specific Exemption, Nonresident Alien A nonresident alien is not entitled to the specific exemption on his income until the end of the year and then only if he makes and files a true and accurate return of his total net income received from all sources within the United States.

Head of Family Defined "When one or more individuals are dependent, either in whole or in principal part, for their actual support and maintenance upon another who by reason of some legal or moral obligation controls and provides for such individuals, the one who assumed the support, maintenance and control of the others is, for Federal income tax

purposes, held to be 'a head of a family' and entitled to the specific exemption of \$4,000 * * *."

**Personal
Exemption—
Ward—
Cestui que
Trust**

A guardian or trustee is allowed to deduct a personal exemption of his ward, or *cestui que trust*, of \$3,000, or, if married, \$4,000.

**Exemption—
Estate**

The estate of a deceased person during the period of administration thereof, is entitled to an exemption of \$3,000.

**Necessary
Business
Expenses
Deductible**

A citizen or resident of the United States in computing his net income is allowed as deductions from gross income, all necessary expenses paid in carrying on his business or trade. Personal, living, or family expenses are not deductible.

**Interest
Paid on
Indebtedness
Deductible**

All interest paid within the year on his indebtedness is deductible.

**Taxes
Deductible**

Taxes paid within the year including those imposed by authority of a State, the United States, or its territories, or possessions, or any foreign country are deductible. Those imposed under authority of any State include county, school district, municipality, or other taxing subdivision, except assessments for local benefits.

Taxes paid by an individual or corporation on securities, to make them tax-free, are not deductible items.

**Local
Assessments
Not
Deductible**

Taxes paid in the nature of local benefits, such as grading, paving, sidewalks, sewerage, etc., are not deductible. These are deemed to be capital expenditures on the theory that the improvement increases the value of the property affected thereby.

**Income Tax
Deductible**

The amounts paid to the Collector and the amounts withheld at the source on account of the income tax are allowable deductions from income, as expenses, in the year in which the taxes are paid to the Collector of Internal Revenue.

Water Rates

Water rates on business or rented property may be deducted as "necessary expenses." They should not be deducted as taxes.

Losses

"Losses actually sustained during the year, arising from fires, storms, shipwreck, or other casualty, and from theft, when such losses are not compensated for by insurance or otherwise" are deductible.

Losses Not in Business or Trade

Under the old income tax law (1913) the deduction of losses sustained outside of the taxpayer's business or trade were not deductible. He was required to account for profits and income from all sources, but was prohibited from deducting any losses not incurred in trade. The amended law, however, provides that in "any transactions entered into for profit, but not connected with his business or trade, the losses actually sustained therein during the year to an amount not exceeding the profits arising therefrom" are deductible. This provision would apply to stock speculations, real estate operations and any speculative venture which is not embraced in the ordinary business or trade of the taxpayer.

Loss Defined

By rulings of the Treasury Department, loss has been defined as the difference between the selling price and the cost, where the selling price is less than the cost.

Losses in One Trade Deductible from Income of Another

According to the English income tax law, an individual engaged in two businesses cannot deduct the loss in one from the income of another. That is not so under our income tax law. The loss sustained in one is deductible from the profit of the other; but the person must be actually engaged in the businesses or trades.

In Trade Defined

" 'In trade' is synonymous with *business*."

"Business" has been defined as—

"That which occupies and engages the time, attention and labor of any one for the purpose of livelihood, profit

or improvement; that which is his personal concern or interest; employment, regular occupation, but it is not necessary that it should be his sole occupation or employment.

"The doing of a single act incidentally or of necessity, not pertaining to the particular business of the person doing the same, will not be considered engaging in or carrying on the business." (T. D. 1989.)

**Bad Debts
Deductible**

"Debts due to the taxpayer actually ascertained to be worthless and charged off within the year" are deductible. (See "Bad Debts," page 103.)

**Depreciation
Deductible**

A reasonable allowance for the exhaustion, wear and tear of property, arising out of its use or employment in the business or trade, is deductible.

In order to render depreciation deductible it must be entered in the books of account in such way that it effects a reduction of the asset account to which it is applicable. This may be accomplished by establishing a Reserve for Depreciation Account or by actual reduction of the asset account itself. The preferable method is to create a reserve account, except, perhaps, with respect to properties that are replaced often.

When the depreciation deducted equals the cost of property depreciated, or in case of purchase prior to March 1, 1913, the fair market value as of that date, then no further deduction will be allowed. (See Chapter IV, on Depreciation, page 68.)

**Depletion
Oil and Gas
Wells**

"In the case of oil and gas wells a reasonable allowance for actual reduction in flow and production to be ascertained not by the flush flow, but by the settled production or regular flow" is a deductible item. When such allowance, however, aggregates the capital originally invested, or in case of purchase prior to March 1, 1913, the fair market value as of that date, then no further allowance for depletion will be deductible.

**Depletion of
Mines**

A reasonable allowance for depletion of mines will be deductible, not to exceed, however, the market value in the mine of the product thereof, which has been moved and sold during the year for which the return and computation are made. As in the case of oil and gas wells, no further allowance for depletion will be allowed when the aggregate thereof equals the capital originally invested, except that in case the property was acquired prior to March 1, 1913, then no deduction will be allowed in excess of the fair market value of the property as of that date.

**Improve-
ments Not
Deductible**

No deduction is allowed for any amount paid out for new buildings, permanent improvements or betterments made to increase the value of any property.

**Restoring
Property Not
Deductible**

No deduction is allowed for amounts expended to restore property or for making good the exhaustion thereof for which an allowance is or has been made. (See page 77.)

**Replaced
Buildings**

A loss sustained by the voluntary removal of a building, for the purpose of erecting one more modern, is not deductible from a return of net income, but such loss may be added to the cost of the new building.

**Buildings
Taken Down
by Order of
Government**

Where a dilapidated building is taken down by order of a building department of the Government, acting under authority of a statute, because such building is a menace to public safety, the owner thereof for the loss sustained might, under some circumstances, be entitled to a deduction of the difference between the cost of the building (exclusive of land) and a reasonable allowance for depreciation for the years of its existence.

**Damage Suits
Judgment**

The test as to the deductibility of an amount paid in compromise or settlement of a claim, or cause of action, for personal injuries is, whether the liability was incurred "in trade." A payment in settlement of a suit

for injuries caused by a delivery truck of a corporation or individual used "in trade" would be deductible, whereas, damages paid for injuries caused by the private automobile of an individual would not be deductible.

Insurance Reserve or Fund Not Deductible

A reserve or fund set aside by either an individual or corporation for insurance purposes is not a deductible item. But an actual loss sustained and charged to such reserve or fund may be deducted.

Fire Insurance Premiums

Fire insurance premiums on a rented dwelling, not occupied by the owner, are deductible.

Accrued Interest on Bonds Purchased Deductible

Usually bonds are sold at a price, plus accrued interest to the date of sale. Such accrued interest, paid by the purchaser, is deductible by him as interest paid.

Commission Paid Real Estate Agent Deductible

Commission paid to a real estate agent for collecting rents and management of property is an allowable deduction.

Political Campaign Expenses

Contributions to the campaign expenses of a political party have been held not to be deductible from income.

Life Insurance Premium

Premiums paid on life insurance policies of the insured are not allowable deductions.

Stock Assessments

Stock assessments are held to be investments of capital and not deductible.

Alimony

Alimony is not a deductible expense.

Living and Household Expenses

The law does not permit of deduction of personal, living and family expenses.

Premium on Fidelity Bond

Where an employee pays the cost of a fidelity bond incident to his employment, he may deduct the cost thereof.

Deductions Nonresident Alien

In computing net income of nonresident aliens, the following deductions are allowed:

Necessary expenses of carrying on business or trade within the United States.

“The proportion of all interest paid within the year by such person on his indebtedness which the gross amount of his income for the year derived from sources within the United States bears to the gross amount of his income for the year derived from all sources within and without the United States, but this deduction shall be allowed only if such person includes in the return required by section eight, all the information necessary for its calculation.”

All taxes paid within the year imposed by authority of the United States, a State, or any political subdivision thereof, not including assessments for local improvements.

Losses actually sustained during the year in trade conducted in the United States, and losses of property within the United States arising from fires, storms, shipwreck, or other casualty, and from theft, when such losses are not compensated for by insurance or otherwise.

The losses of nonresident aliens sustained in trade or speculative transactions not in trade, on property acquired prior to March 1, 1913, shall be determined on a basis of the fair market price or value of such property as of March 1, 1913.

Losses sustained in transactions not connected with his business or trade arising in the United States within the year not exceeding the profit derived therefrom.

Bad debts sustained in business or trade within the United States, ascertained to be worthless and actually charged off within the year.

A reasonable allowance for depreciation and depletion of property within the United States sustained during the year arising out of its use or employment in business or trade, to the same extent and with the same limitations as are applicable to properties of citizens and resident aliens.

Credit for the amount of normal tax paid or withheld at the source, including that on dividends and any

other income on which the normal tax is exempt or paid at the source.

Specific exemptions, provided a true and accurate return is made and filed in due time.

V. TAX WITHHELD AT SOURCE.

Withholding Tax

The provisions of law requiring the withholding of tax by payers of income applies only to the normal tax and is not applicable to corporations formed under the laws of the United States or any State or Territory thereof, and copartnerships composed of citizens or resident aliens of the United States.

Normal Tax Withheld

For the calendar year 1916, the law provides that only 1 per cent. shall be withheld, the recipient of income to account for the remaining 1 per cent. On and after January 1, 1917, the entire normal tax of 2 per cent. shall be withheld..

Deduction of Tax from Interest on Bonds and Mortgages of Corporations

The amount of the normal tax shall be deducted and withheld and paid to the Government from all fixed and determinable annual and periodical gains, profits and income derived from interest upon bonds and mortgages or deeds of trust or other similar obligations of corporations, joint-stock companies, associations and insurance companies, irrespective of when paid, annually or at shorter or longer periods, although such interest does not amount to \$3,000 per annum.

Likewise, the amount of such tax shall be deducted and withheld from coupons, checks or bills of exchange for or in payment of interest upon bonds of foreign countries and upon foreign mortgages or like obligations; also, from coupons, checks or bills of exchange in payment of any dividends upon the stock or interest upon the obligations of foreign organizations, associations and insurance companies engaged in business in foreign countries. "And the tax in such cases shall be withheld, deducted and returned for and in behalf of any person subject to the tax hereinbefore imposed, al-

though such interest or dividends do not exceed \$3,000, by:

1. "Any banker or person who shall sell or otherwise realize, coupons, checks or bills of exchange, drawn or made in payment of any such interest or dividends (not payable in the United States).

2. "Any person who shall obtain payment (not in the United States) in behalf of another, of such dividends and interest by means of coupons, checks or bills of exchange, and also

3. "Any dealer in such coupons who shall purchase the same for any such dividends or interest (not payable in the United States), otherwise than from a banker or another dealer in such coupons."

License
Required by
Collectors
of Certain
Foreign
Income

"All persons, firms, or corporations undertaking as a matter of business or for profit the collection of foreign payments of such interest or dividends by means of coupons, checks, or bills of exchange shall obtain a license from the Commissioner of Internal Revenue, and shall be subject to such regulations enabling the Government to ascertain and verify the due withholding and payment of the income tax required to be withheld and paid as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe; and any person who shall knowingly undertake to collect such payments as aforesaid without having obtained a license therefor, or without complying with such regulations, shall be deemed guilty of a misdemeanor and for each offense be fined in a sum not exceeding \$5,000, or imprisoned for a term not exceeding one year, or both, in the discretion of the court."

Tax Free
Bonds

The law does not recognize tax free covenants in bonds. "In the case of bonds or other indebtedness which have been issued with a guaranty that the interest payable thereon shall be free from taxation, no deduction for the payment of the tax herein imposed, or any

other tax paid pursuant to such guaranty, shall be allowed."

**Scrip
Certificates**

"Scrip certificates issued by a corporation to its stockholders in lieu of dividends, such scrip certificates bearing interest and redeemable at a specified time not longer than one year from date of issue, are not corporate obligations similar to bonds, mortgages, or deeds of trust, and the interest payable thereon will not be subject to withholding except when the amount thereof payable to an individual in a calendar year exceeds \$3,000. Payment in scrip is held to be equivalent to payment in cash, and when the amount of interest paid on such scrip to any one individual in a calendar year is in excess of \$3,000 the tax must be withheld and accounted for in excess of exemption claimed." (T. D. 2090, as amended by T. D. 2152.)

**Withholding
Tax on
Commercial
Paper of
Corporations**

"Interest payments on ordinary, bankable commercial paper of corporations, payable to individuals, are subject to withholding at the source only when the payment to any one individual within a taxable year exceeds \$3,000. On all other obligations of corporations, etc., payable to individuals, interest payments are subject to withholding regardless of the amount of interest payment.

"A simple promissory note not exceeding one year in time, is not 'similar to bonds, mortgages or deeds of trust of corporations,' and the interest on such a note is not subject to withholding except when the amount of interest thereon, payable to an individual in any one year is in excess of \$3,000 or when the interest thereon is payable to a nonresident alien, in which latter case the tax should be withheld, regardless of the amount of interest payment." (T. D. 2090.)

**Compulsory
Deduction
at Source
on Income
in Excess
of \$3,000**

Except on income derived from dividends on capital stock or net earnings of corporations, the normal tax shall be withheld at the source on all payments to individuals in excess of \$3,000 for any year, on all gains,

profits and income, less the personal exemption, where a certificate of exemption has been filed with the payer. This provision is applicable to "all persons, firms, co-partnerships, companies, corporations, joint stock companies or associations and insurance companies, in whatever capacity acting, including lessees or mortgagors of real or personal property, trustees acting in any trust capacity, executors, administrators, receivers, conservators, employers and all officers and employees of the United States, having the control, receipt, custody, disposal or payment of interest, rent, salaries, wages, premiums, annuities, compensation, remuneration, emoluments or other fixed or determinable annual or periodical gains, profits and income of another person." All those required to withhold at the source, as above indicated, are made personally liable for such tax as they are required to withhold.

The taxes withheld should be reported on Form 1042 Revised, and filed annually with the Collector on or before March 1st of each year.

**Specific
Exemption—
How
Obtained**

No person shall receive the benefit of the personal exemption except where he or she shall file, not less than thirty days prior to the day on which the return is due, with the person who is required to withhold and pay the tax, a signed notice in writing, claiming the benefit of such exemption (Form 1007 Revised); thereupon no tax shall be withheld upon the amount of such exemption.

**Penalty for
False
Representa-
tion**

Any person who knowingly makes a false statement or false representation, for the purpose of obtaining any allowance or reduction by virtue of a claim for exemption, either for himself or for any other person, will be liable to a penalty of not exceeding \$300.

**Certificate
of
Exemption**

The certificate of exemption filed by an individual with the payer of income shall be filed with the return of such paying debtor. (Form 1007 Revised.)

**Deductions
Excess Tax
Withheld**

A person to become entitled to the benefit of any deduction of normal tax withheld at the source in excess of the taxpayer's liability for normal tax, or for refund of amount of excess tax withheld, must, not less than thirty days prior to the day on which the return of his income is due, either:

1. "File with the person who is required to withhold and pay tax for him, a true and correct return (Form 1008 Revised) of his gains, profits, and income from all other sources, and also the deductions asked for, and the showing thus made shall then become a part of the return to be made in his behalf by the person required to withhold and pay the tax, or

2. "Likewise make application for deductions to the Collector of the district in which return is made or to be made for him." (Form 1008 Revised.)

**Claiming
Allowable
Deductions**

In cases where the allowable deductions are known at the time of receipt of fixed, annual, or periodical income by individuals, whose income is subject to withholding of tax, it has been provided by T. D. 2412, released for publication December 15, 1916, that "the person entitled to and receiving such income may file with the person, firm, or corporation making the payment, a certificate (Form 1088), under penalty for false claim, stating the amount of such deductions and making a claim for an allowance of the same, whereupon there shall be no withholding upon the amount of such claim and such certificate shall become a part of the return to be made in behalf of the person making the claim. When because of such claim no tax shall have been withheld, the certificate nevertheless shall be forwarded, with letter of transmittal, to the Collector of Internal Revenue for the District in which the withholding agent resides."

Rent

On rent payable to an individual in excess of \$3,000 per annum, the normal tax must be withheld at the source of payment.

Where a tenant rents two or more pieces of property and the total rental exceeds \$3,000 per annum the normal tax must be deducted and withheld, less, of course, the specific exemption if claim therefor is made in due time.

**Interest on
Bank
Account**

Interest on bank balances is returnable in the year credited by the bank. The tax on such interest, however, even in excess of \$3,000 per annum, is not subject to be withheld at the source.

**Real Estate
Agent Shall
Not
Withhold**

A real estate agent collecting rents for a landlord shall not withhold the normal tax even in excess of \$3,000. He stands in the position of the landlord and receives collections for and in behalf of such landlord. (T. D. 2090.)

**Tax
Withheld
Deductible
by
Individual**

All taxes withheld at the source shall be an allowance in the return of the person on whose income such tax has been or is to be paid at the source.

**Traveling
Expenses
Paid by
Salesmen**

Where a salary is paid to a salesman out of which he is required to pay his traveling expenses, the tax should not be withheld at the source.

**Salesmen's
Commissions
Profit
Sharing
Bonuses**

Irregular or indefinite income as to amount and time of accrual, such as commissions earned by a salesman, are not subject to withholding at the source, except where such commission can be definitely determined, as in the case where it is based on sales. Wherever a commission is definitely determinable the normal tax should be withheld.

Where both a salary and commission are paid, the tax withheld should be based on both inclusive, less personal exemption of the recipient. This is true also of amounts paid as "profit-sharing" or bonuses. The tax on the bonus should be withheld in the year that it is paid or credited, not necessarily in the year, on the income of which, such bonus was computed.

Indemnity to Withholding Party The law indemnifies those who withhold the normal tax at the source against liability to the person on whose income the deduction is made.

Return of Income Tax Withheld at Source The normal tax withheld by corporations on salaries and compensation of officers and employees, in excess of \$3,000, must be reported in Form 1042 Revised. This return should accompany the return of annual net income. Failure to file such form (1042 Revised) makes the corporation subject to the penalty imposed for failure to make return in due time.

Withholding Tax Nonresident Alien Although the law does not specifically so state, it may reasonably be inferred from a consideration of all the provisions bearing upon the withholding of tax on income of nonresident alien individuals, that the payers of such income should withhold the normal tax thereon irrespective of amount paid, except in the case of dividends.

Provision for Exemption from Withholding Tax on Income of Nonresident Alien Corporations The law provides that the normal tax is to be withheld at the source of payment from income derived within the United States by nonresident alien firms, co-partnerships, companies, corporations, joint-stock companies or associations and insurance companies that are not engaged in business or trade within the United States and have no office or place of business therein.

“The income of such nonresident alien corporations, etc., which is subject to the withholding provisions of the law is that derived from ‘interest on bonds and mortgages or deeds of trust or similar obligations of domestic or other resident corporations, joint-stock companies or associations, and insurance companies,’ regardless of amount.

“And likewise the withholding provisions of the law ‘shall be made applicable to income derived from dividends upon the capital stock or from the net earnings of domestic or other resident corporations, joint stock com-

panies or associations, and insurance companies by non-resident alien companies, corporations, joint-stock companies or associations, and insurance companies not engaged in business or trade within the United States and not having any office or place of business therein,' regardless of amount.

"Including and from and after September 9, 1916, and to and including December 31, 1916, the normal income tax will be withheld from such income at the rate of 1 per cent on the amount thereof. Including and from and after January 1, 1917, the normal income tax will be withheld from such income at the rate of 2 per cent on the amount thereof.

"To enable debtor corporations, etc., in the United States to distinguish between nonresident alien corporations, etc., which have and those which do not have 'any office or place of business' in the United States and also to enable such nonresident alien corporations, etc., as have an 'office or place of business' in the United States, to claim exemption from withholding of the normal income tax at the source on their income from sources within the United States, as specified by the statute, a certificate * * *" has been provided known as Form 1086.

"The normal income tax on the character of income herein specified and payable to nonresident firms, copartnerships, corporations, etc., will be deducted, withheld, and paid to the proper officer of the United States Government authorized to receive it, unless the corporation, etc., entitled to the payment shall file * * *" such certificate (under penalty for false claim) and only those non-resident firms, corporations, etc., which have an "office or place of business" in the United States can use such certificate. "The corporations, etc., which are permitted to use the certificate herein provided are required to make and render a return of income to the collector of internal revenue for the district in which

they have their office or place of business * * *.”
(T. D. 2374.)

VI. FARMS AND FARMERS.

Farms and Farmers Defined

“The term ‘farm’ as herein used embraces the farm in the ordinary accepted sense, plantations, ranches, stock farms, dairy farms, poultry farms, fruit farms, truck farms and all lands used for similar purposes; and for the purposes of this decision all persons who cultivate, operate or manage farms for gain or profit, either as owners or tenants, are designated as ‘farmers.’

Income from Farms

“All gains, profits, and income derived from the sale or exchange of farm products, whether produced on a farm or purchased and resold by a farmer, shall be included in the return of income for the year in which the products were actually marketed and sold; and

Prepaid Farm Expenses Deductible

“All allowable deductions, including the legitimate expenses incident to the production of that year or future years, may be claimed in the return of income for the tax year in which the right to such deductions shall arise, although the products to which such expenses and deductions are incidental may not have been sold or exchanged for money; or a money equivalent, during the year for which the return is rendered.

Farming on Shares

“Rents received in crop shares shall likewise be returned as of the year in which the crop shares are reduced to money or a money equivalent, and

Farm Expenses Deductible in Year Paid

“Allowable deductions, likewise, shall be claimed in the return of income for the tax year to which they apply, although expenses and deductions may be incident to products which remained unsold at the end of the year for which the deductions are claimed.

Loss in
Value of
Farm
Products
Held for
Advance

“ When farm products are held for favorable market prices, no deduction on account of shrinkage in weight or physical value, or losses by reason of such shrinkage or deterioration in storage, shall be allowed.

Live Stock
Purchased

“ Cost of stock purchased for resale is an allowable deduction under the item of expense, but money expended for stock for breeding purposes is regarded as capital invested, and amounts so expended do not constitute allowable deductions except as hereinafter stated.

Loss by
Death of
Live Stock
Deductible

“ Where stock has been purchased for any purpose, and afterwards dies from disease or injury, or is killed by order of the authorities of a State, or the United States, and the cost thereof has not been claimed as an item of expense, the actual purchase price of such stock, less any depreciation which may have been previously claimed, may be deducted as a loss. Property destroyed by order of the authorities of a State, or of the United States, may, in a like manner, be claimed as a loss.

Receipts for
Condemned
Live Stock

“ But if reimbursement is made by a State or the United States, in whole or in part, on account of stock killed or property destroyed, the amount received shall be reported as income for the year in which reimbursement is made.

Farm
Machinery
Not
Deductible

“ The cost of farm machinery is not an allowable deduction as an item of expense, but the cost of ordinary tools may be included under this item.

Depreciation
Allowed
on Farm
Property

“ Under the sixth deduction enumerated in Paragraph ‘B,’ providing for ‘a reasonable allowance for the exhaustion, wear, and tear of property arising out of its use or employment’ * * *, there may be claimed a reasonable allowance for depreciation on farm buildings (other than a dwelling occupied by the owner), farm machinery, and other physical property, including stock purchased for breeding purposes; but no claim for depre-

ciation on stock raised or purchased for resale will be allowed.

**Farmers
Books of
Account**

“Farmers who keep books, according to some approved method of accounting, which clearly show the net income, may prepare their returns from such books, although the method of accounting may not be strictly in accordance with the provisions of this decision.

**Farm
Maintained
Only for
Recreation**

“A person cultivating or operating a farm, for recreation or pleasure, on a basis other than the recognized principles of commercial farming, the result of which is a continual loss from year to year, is not regarded as a farmer. In such cases, if the expenses incurred in connection with the farm are in excess of the receipts therefrom, the entire receipts from sale of products may be ignored in rendering a return of income; and the expenses incurred being regarded as personal expenses will not constitute allowable deductions in the return of income derived from other sources.” (T. D. 2153.)

CHAPTER II

INCOME TAX AS APPLIED TO PARTNERSHIPS

VII. GENERAL PARTNERSHIPS

Partners

Persons conducting business in partnership shall be liable for income tax only in their individual capacity.

Returns by Partnerships Not Required

Partnerships are not required to make returns except when specifically ordered to do so by the Collector of Internal Revenue. In such case, the return should be prepared on Form 1065.

The individual members of the partnership are required to include in their returns their prorata share of the earnings of partnerships as shown by the books of account, whether such earnings were distributed or not.

Income When Accrued

"It is held that the income from a partnership accrues to the individual partner at the time his distributive interest is determined and reducible to possession. In the returns of income made by individuals for the calendar year, therefore, there should be included such income accruing from the business of partnerships for their business years as may have been definitely ascertained by means of a book balance, whether distributed or not. In other words, members of partnerships are required to make returns of income like other individuals for the calendar year, and should include in their returns" the net proceeds of their interest in partnership profits ascertained at the end of the business year falling within the calendar year for which the individual return is being rendered." (T. D. 2090.)

Partnership Income Not Subject to Withholding

Income due to a partnership is not subject to the withholding of normal tax at the source, because a partnership, apart from its members, is not taxable.

**Dividends
to
Partnership**

Partnership earnings must include dividends on the capital stock of corporations, joint-stock companies, or associations, or insurance companies owned by the partnership.

**Credits on
Individual
Returns of
Partners**

From the net distributive interests reported by the partners "there shall be excluded their proportionate shares received from interest on the obligations of a State or any political or taxing subdivision thereof, and upon the obligations of the United States and its possessions, and all taxes paid to the United States or to any possession thereof, or to any State, county or taxing subdivision of a State, and * * * for the purpose of computing the normal tax there shall be allowed a credit * * * for their proportionate share of the profits derived from dividends."

**Partnership
Expenses**

None of the expenses of a partnership shall be deducted from the return of net income of an individual.

**Life
Insurance
of Partners**

"Premiums paid on life insurance taken out by a partnership upon the lives of individual members of such partnership, constitute allowable deductions in ascertaining the net earnings of the partnership. However, when such policies mature, or upon the death of the insured partner, the amount received as life insurance should be included in the gross income of the partnership." (T. D. 2090.)

VIII. LIMITED PARTNERSHIPS.**Limited
Partnership**

In the administration of the income tax law it has been ruled that a limited partnership, with respect to its income, is subject to the provisions of law applicable to corporations; that is to say, a limited partnership must make its return on the blank provided for corporations (Form 1031 Revised), and must pay the normal tax as shown thereby.

Partnerships are required to prepare and file lists of the persons receiving from them compensation in excess of \$3,000 per annum (Form 1042 Revised).

A limited partnership is one having one or more "special partners" whose liability is limited to the amount invested. It is created by complying with the State laws providing for that form of partnership. The usual requirements are that such partnership file certain certificates stating: the name of firm under which the limited partnership is to be conducted, its principal place of business, the general nature of the business intended to be transacted, the names of all general and special partners and their respective residences, the names of the special partners and the amount of capital contributed by each of them, and the time that such partnership shall commence and terminate.

A limited partnership can only be created by complying with requirements of the statute of the State under which it is created.

**Profits
Limited
Partnerships**

"The profits of limited partnerships making returns in the same manner as corporations make returns will be treated the same as dividends of corporations and will be returned in the returns of individuals in the same manner as are dividends upon the stock of corporations; that is to say, the dividends received from such limited partnerships will not be subject to the normal tax in the hands of the members of the partnership receiving the same." (T. D. 2137.)

CHAPTER III.

INCOME TAX AS APPLIED TO CORPORATIONS.

IX. GENERAL PROVISIONS.

Income of
Corporations
Organized
in United
States

The Federal income tax will be levied, assessed, collected, and paid annually upon the total net income from all sources, received in the preceding calendar or fiscal year,¹ by every corporation, joint-stock company or association, or insurance company, organized in the United States.

Income of
Foreign
Corporations

The tax will be paid annually by every corporation, joint-stock company or association, or insurance company organized under the laws of any foreign country, upon the total net income received from all sources within the United States in the preceding year, "including interest on bonds, notes or other interest-bearing obligations of residents, corporate or otherwise, and including the income derived from dividends on capital stock or from net earnings of resident corporations, joint-stock companies or associations, or insurance companies whose net income is taxable under this title."

Rate

The tax upon the income of corporations is 2 per cent.

Tax Year

The calendar year comprises the tax year, except that corporations may designate their own fiscal year by complying with certain requirements as to notice to the Collector, etc. See page 47.

Beginning
1916

The rate of 2 per cent. is applicable to the entire calendar year of 1916 and every year thereafter.

¹ A return for the fiscal year of a corporation, when other than the calendar year, is only acceptable after compliance with requirements in connection therewith. See page 47.

**No Specific
Exemption
of Net
Income**

Under the Corporation Excise Tax of 1909, net income of corporations to the amount of \$5,000 per annum was exempt. No such provision is contained in the present income tax law. All net income of corporations is subject to the tax of 2 per cent.

**Foreign
Income
Taxable**

A corporation organized in the United States, or any possession of the United States, must include in its return income from all sources, whether derived in the United States, its possessions, or in foreign countries.

X. RETURNS OF CORPORATIONS.**Form of
Return**

All corporations, domestic and foreign, are required to make returns on Form 1031 Revised, except insurance companies; whose returns are made on Form 1030 Revised.

**Return of
Domestic
Corporation**

The return of a domestic corporation shall be made to the Collector of the district in which is located its principal office, or where its books of account and other data are kept, from which the return is prepared.

**Return of
Foreign
Corporation**

In the case of a foreign corporation, the return should be filed with the Collector of the district in which is located its principal place of business in the United States, or if it has no principal place of business, office or agency within the United States, then with the Collector of Internal Revenue at Baltimore, Maryland.

**Returns
Must
be Made for
Calendar
Year
Unless
Otherwise
Authorized
Due Date
of Return**

Returns made for any period other than a calendar year, except where the corporation has given due notice to the Collector of Internal Revenue, in compliance with requirements of law, will not be accepted by the Collector.

All returns shall be filed with the Collector on or before the 1st day of March of each year unless the fiscal year of the corporation has been designated in the manner prescribed, in which case the return must be

filed within sixty days after the close of such designated fiscal year.

When Last
Filing Day
Falls on
Sunday or
Legal
Holiday

When the due date of filing a return, March 1st, or where an extension has been obtained, the last day of such extended time, falls on Sunday or a legal holiday, the last due date will be the day next following such Sunday or legal holiday. In case the return is transmitted by mail it should be posted in ample time to reach the Collector's office "under ordinary handling of the mails, on or before the date on which the return is thus made due in the office of the Collector."

Execution
of Returns

"The return shall be sworn to by the President, Vice-president or other principal officer, and by the Treasurer or Assistant Treasurer."

When Tax
Payable

Corporations making returns on the basis of the calendar year will be notified of the amount of their assessments on or before the first day of June of each year and the amount of said assessment shall be paid on or before the fifteenth day of June.

Delayed
Payment
Penalty

To any sum or sums due and unpaid after ten days' notice and demand thereof by the Collector, there shall be added interest at the rate of one per cent. per month upon said tax from the time the same became due, and a further penalty of five per cent. on the amount of the tax unpaid.

Returns for
Fiscal Year
of
Corporation

A corporation whose fiscal year is not the calendar year, may make its return on the basis of its fiscal year by complying with prescribed requirements. The designated fiscal year must end on the last day of some month. The corporation shall give notice to the Collector of the district in which its principal office is located, at any time not less than 30 days prior to March 1st of the year in which its return would be filed if made upon the basis of the calendar year. Although not required under the law, it is advisable to obtain the consent of the

Collector before proceeding to file returns for any period other than the calendar year.

Illustration: The fiscal year of a corporation ends on June 30th. It has made its returns say, for the year 1915 based on the calendar year (January 1st to December 31st, 1915). In order now (December 1st, 1916), to obtain permission to make its return on the basis of its fiscal year (June 30th) it must serve notice on the Collector not later than 30 days prior to March 1st, 1917 (on or before January 29th, 1917). Its return for six months ended June 30th, 1916, must be filed on or before March 1st, 1917, and the return for year ending June 30th, 1917, must be filed within sixty days thereafter (on or before August 29th, 1917). From that time on its annual return will be made for each year ending June 30th, which return must be filed within 60 days, *i. e.*, on or before August 29th.

**Fiscal Year
When Tax
Payable**

The tax under the designated fiscal year becomes due and payable 105 days after the last due date upon which it is required to file the return, which, in the illustration cited, would be December 12th of the same year that the return is made.

**Extension
of Time to
File
Return**

Section 3176 of the revised statute provides that: "If the failure to file a return or list is due to sickness or absence, the collector may allow such further time, not exceeding thirty days, for making and filing the return or list as he deems proper." Application for such extension should be made to the Collector on or before the first day of March.

Section 14 (c) provides, further, "That the Commissioner of Internal Revenue shall have authority, in the case of either corporations or individuals, to grant a reasonable extension of time in meritorious cases, as he may deem proper."

**Failure to
File Return
Penalty**

In case of failure to file a return within the time prescribed by law or by the Collector, the Commissioner of

Internal Revenue shall add fifty per cent. of the amount of the tax. When a return is voluntarily, and without notice from the Collector, filed after the due time, and it is shown that the failure to file the return was due to a reasonable cause and not to willful neglect, no such addition shall be made to the tax.

False or
Fraudulent
Return
Penalty

In case a false or fraudulent return is willfully made, the Commissioner of Internal Revenue shall add to the tax one hundred per cent. of its amount. Section 3176 of the revised statute further provides that "The amount so added to any tax shall be collected at the same time and in the same manner and as part of the tax unless the tax has been paid before the discovery of the neglect, falsity, or fraud, in which case the amount so added shall be collected in the same manner as the tax."

Section 18 of the income tax law further states that "Any individual or any officer of any corporation, joint-stock company or association or insurance company required by law to make, render, sign or verify any return who makes any false or fraudulent return or statement with intent to defeat or evade the assessment required by this title to be made shall be guilty of a misdemeanor, and shall be fined not exceeding \$2,000 or be imprisoned not exceeding one year, or both, in the discretion of the court, with the costs of prosecution.

Refusal or
Neglect to
Make
Return
Penalty

Section 14 (c) contains the provision that "If any of the corporations, joint-stock companies or associations, or insurance companies aforesaid shall refuse or neglect to make a return at the time or times hereinbefore specified in each year, or shall render a false or fraudulent return, such corporation, joint-stock company or association, or insurance company shall be liable to a penalty of not exceeding \$10,000."

Return by
Commissioner of
Internal
Revenue

In cases of refusal or neglect to make return, and in cases of erroneous, false or fraudulent returns, the Commissioner of Internal Revenue shall, upon the dis-

covery thereof, at any time within three years after such return is due, make a return upon information obtained as provided for by existing law. The assessment, based upon a return so made, shall become due and payable immediately upon notification of the amount thereof.

**Second
Assessment**

**Recovery
of Amount
Paid**

“When a second assessment is made in case of any list, statement, or return, which in the opinion of the collector or deputy collector was false or fraudulent, or contained any understatement or undervaluation, no tax collected under such assessment shall be recovered by any suit unless it is proved that the said list, statement, or return was not false nor fraudulent and did not contain any understatement or undervaluation; but this section shall not apply to statements or returns made or to be made in good faith under the laws of the United States regarding annual depreciation of oil or gas wells and mines.” (Section 3225, revised statute.)

**Publicity
of Returns**

The contents of returns of net income constitute a public record, open to inspection “only upon the order of the President under rules and regulations prescribed by the Secretary of the Treasury and approved by the President.”

**Designated
Fiscal
Year
Apportioning
Income
for 1916**

A corporation that has designated its own fiscal year shall pay a tax on the proportion of the total net income returned for the fiscal year ending prior to December 31, 1916, which the period between January 1, 1916, and the end of such fiscal year bears to the whole of such fiscal year; that is to say, a corporation, the fiscal year of which ends on November 30, 1916, shall pay a tax of 1 per cent. (under the old law) on 1/12 of its net income of said fiscal year, for the month of December, 1915, and 2 per cent. on 11/12 of said income, for period from January 1 to November 30, 1916. Thereafter it will pay at the rate of 2 per cent.

Corporations Incompletely Organized

A corporation which has not been completely organized, that is to say, has not accepted the charter granted to it, and has transacted no business, is relieved of the necessity of making a return as a corporation until its organization has been completed.

All Existing Corporations Must Make Returns

The fact that a corporation has received no income is no excuse for failure to make return. The duty to make a return depends upon corporate existence and not upon receipt of income.

Returns of Corporations Maintaining Foreign Branches

In the event that it should not be possible for a corporation to obtain from its foreign branches the necessary data from which to make a complete and accurate report, it is advisable to prepare and file a tentative return showing, in so far as obtainable, the income from all operations of such company, to which should be attached a memorandum to the effect that, by reason of inability to obtain the necessary information in due time the income reported does not include income from all sources. Such report should be marked "Tentative Return." When the necessary data is received an amended return, so marked, should be filed, and the assessment will then be fixed thereon.

Collectors of Internal Revenue are permitted to accept tentative returns in cases other than that mentioned above (foreign branches) where true returns cannot be rendered in due time or within the extended time as provided by law. The practice, however, should only be resorted to when it is unavoidable.

Returns of Holding Companies

"In a case wherein a holding company actually takes up each month on its books its proportionate share of the earnings of the underlying companies, such holding company will be required to include in its gross income the amounts thus taken up regardless of the fact that the same may not have been actually paid to it in cash. The fact that the underlying companies credit to the

holding company the amount of earnings to which it is entitled on the basis of the stock it holds, together with the fact that the holding company takes up on its books the amount thus credited, renders it incumbent upon the holding company to return these amounts as income, regardless of the fact that the underlying companies needed these earnings and used them in making extensions and improvements and in furtherance of their business. Expenditures for such extensions and improvements being chargeable to the property account of the subsidiary companies are not deductible from the gross income and will therefore not have the effect to reduce the earnings to their respective shares of which the stockholders are entitled." (Supplement to Black on Income Taxes.)

Returns of Subsidiary Companies

The existence of a corporation is sufficient to compel the rendering of a return of net income. The fact that a subsidiary company has had no income and no expenses does not excuse it from making a return. In case there has been neither income nor expenses, the return should specifically state such facts.

It is quite usual for a subsidiary company to keep its books and maintain its principal office at a place other than where its operations are conducted. In such case, as where the subsidiary company's office is maintained in the place where the holding company has its office, the return should be made in the district of the place where its books of account are kept.

It is customary for subsidiary companies to transmit to the parent company all of its earnings after deducting its expenses. Such income received by the parent company is construed to be dividends by the subsidiary company, subject to tax in the return of the parent company, as well as in the return of the subsidiary.

Receivers, Trustees, Assignees

Receivers and trustees in bankruptcy, and assignees, who are operating the property or business of corporations that are subject to the income tax must make re-

turns of net income for such corporations. Corporations in the hands of receivers, trustees or conservators are subject to the income tax and must make returns.

Returns
Interstate
Commerce
Corporations

It has been ruled that corporations required to keep their books according to a uniform system of accounting prescribed by the Interstate Commerce Commission, may supply the information called for by Form 1031 "by classes rather than giving the items in detail, classifying the income and expenditures in the same manner as is required as to these items by the Interstate Commerce Commission."

Books of
Account of
Corporations

"A corporation, joint-stock company or association, or insurance company, keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect its income, may, subject to regulations made by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, make its return upon the basis upon which its accounts are kept, in which case the tax shall be computed upon its income as so returned." (See Chapter V, "Preparation of Income Tax Return," page 86.)

Appreciation
Not
Income

An increase in the book value of assets to conform with appraisal values, or for any other purpose, does not render such increase taxable as income.

XI. EXEMPT ORGANIZATIONS.

Exempt
Organiza-
tions

The following classes of corporations and organizations are exempt from requirements of the income tax law except the withholding of normal tax at the source, and reporting and paying the same to the Government. (See: Exempt corporations subject to withholding, page 55.)

First—Labor, agricultural or horticultural organization;
Second—Mutual savings bank not having a capital stock represented by shares;

- Third—Fraternal beneficiary society, order, or association, operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association or their dependents;
- Fourth—Domestic building and loan association and co-operative banks without capital stock organized and operated for mutual purposes and without profit;
- Fifth—Cemetery company owned and operated exclusively for the benefit of its members;
- Sixth—Corporation or association organized and operated exclusively for religious, charitable, scientific, or educational purposes, no part of the net income of which inures to the benefit of any private stockholder or individual;
- Seventh—Business league, chamber of commerce, or board of trade, not organized for profit and no part of the net income of which inures to the benefit of any private stockholder or individual;
- Eighth—Civic league or organization not organized for profit but operated exclusively for the promotion of social welfare;
- Ninth—Club organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net income of which inures to the benefit of any private stockholder or member;
- Tenth—Farmers, or other mutual hail, cyclone, or fire insurance company, mutual ditch or irrigation company, mutual or co-operative telephone company; or like organization of a purely local character; the income of which consists solely of assessments, dues, and fees collected from members for the sole purpose of meeting its expenses;

Eleventh—Farmers', fruit growers', or like association, organized and operated as a sales agent for the purpose of marketing the products of its members and turning back to them the proceeds of sales, less the necessary selling expenses, on the basis of the quantity of produce furnished by them;

Twelfth—Corporation or association organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt from the tax imposed by this title; or

Thirteenth—Federal land banks and national farm-loan associations as provided in section twenty-six of the Act approved July seventeenth, nineteen hundred and sixteen, entitled "An act to provide capital for agricultural development, to create standard forms of investment based upon farm mortgage, to equalize rates of interest upon farm loans, to furnish a market for United States bonds, to create Government depositaries and financial agents for the United States, and for other purposes."

Fourteenth—Joint-stock land banks as to income derived from bonds or debentures of other joint-stock land banks or any Federal land bank belonging to such joint-stock land bank.

**Exempt
Corporations
Subject to
Withholding**

Under the language of the income tax act of 1913 it was held that exempt corporations and organizations were exempt from all provisions of the law. Under the present law, however, enacted September 8, 1916, it has been ruled by the Commissioner of Internal Revenue that the fourteen different kinds of exempt corporations and organizations named in the law are relieved only from the tax on their income, and "that said corporations and organizations are required to answer under all the other provisions of the statute as to withholding and making returns of tax withheld."

**Organizations
Doubtful
as to
Exemption**

In all cases where there is a question of doubt as to whether an organization is or is not exempt, it is recommended that a special ruling be obtained from the Commissioner of Internal Revenue. The application for such ruling should be accompanied by an affidavit stating:

- (a) The purpose and nature of the organization
- (b) The source of its income
- (c) The disposition of its income
- (d) Whether or not any of its net income will inure to the benefit of any private stockholder or individual.

**Foreign
Organizations**

It has been ruled that foreign as well as domestic corporations and organizations enumerated in the exempt list are included therein.

**Close
Corporation**

A so-called "close corporation," which usually consists of members of a family, is not such corporation as is exempt from the requirements of the income tax law.

XII. INCOME OF CORPORATIONS.

**Net
Income**

The term "net income" as used in the income tax law with respect to corporations, may be defined as the "gross income" less deductions allowed by law.

**Gross
Income
Manufacturing
Corporations**

"Gross income of manufacturing companies shall consist of the total sales of manufactured goods during the year covered by the return, increased or decreased by the gain or loss as shown by the inventories of finished and unfinished products, raw material, etc., at the beginning and end of the year. To this amount should be added the income, gains, or profits from all other sources as shown by the books of account." (Art. 104, Reg. 33¹) (See: Manufacturing Corporation operating Cost-system, page 110.)

¹ Refers to regulations issued by the Treasury Department.

**Gross
Income
Mercantile
Corporations**

"Gross income of mercantile companies shall include the total merchandise sales during the year, increased or decreased by the gain or loss as shown by the inventories of merchandise at the beginning and end of the year for which the return is made; to this amount should be added the income, gains, or profits derived from all other sources as shown by the books of account." (Art. 105, Reg. 33.)

**Gross
Income
Miscel-
laneous
Corporations**

"Gross income of miscellaneous corporations consists of the total revenue derived from the operation and management of the business and property of the corporation making the return, together with all amounts of income, including the income, gains, or profits from all other sources, as shown by the books of account." (Art. 106, Reg. 33.)

**Gross
Income
Contracting
Corporations**

"In the case of a large contracting company, which has numerous uncompleted contracts which probably, in some cases, run for periods of several years, there does not appear to be any objection to such corporation preparing its return in such manner that its gross income will be arrived at on the basis of completed work—that is to say, on jobs which have been finally completed and payments made during the year in which the return is made. If the gross income is arrived at in this method, the deductions from gross income should be limited to the expenditures made on account of such completed contracts." (T. D. 2161.)

**Gross
Income
From All
Sources**

"It will be noted from these definitions that the gross income embraces not only the operating revenues, but also income, gains, or profits from all other sources, such as rentals, royalties, interest, and dividends from stock owned in other corporations * * *, also profits made from the sale of assets, investments, etc." (Art. 107, Reg. 33.)

**Gross
Income
Insurance
Companies**

“Gross income of insurance companies consists of the total revenue derived from the operation of the business, including income, gains, or profits from all other sources, as shown by the entries on the books of account within the calendar or fiscal year for which the return is made, except as modified by the express exemptions of the articles which apply to mutual fire, mutual marine, and life insurance companies.” (Art. 97, Reg. 33.)

**Mutual
Companies**

Mutual associations or companies, such as, fire, employers' liability, workmen's compensation, casualty insurance companies, that require their members to make premium deposits to provide for losses and expenses, are not required to return as income any portion of the premium deposits returned to policyholders. Income from all other sources, however, including that received from its members as premium deposits, retained by the companies for purposes other than the payment of losses and expenses and reinsurance reserves, is returnable as income.

**Dividends
Received by
Corporation**

The income received by corporations in the form of dividends of other corporations is subject to tax in the hands of the company paying the same, as a part of its net earnings, as well as in the hands of the corporation receiving the same. Hence, there is a double tax on dividends paid to a corporate stockholder.

**Dividends
Payable in
Securities**

Dividends may be declared payable in cash or the equivalent of cash. Where dividends are declared payable in securities of another corporation or of a foreign government, the value placed upon such securities should be the fair cash market value thereof as at the time the dividend is declared.

**Profit on
Sales of
Capital
Assets**

Profit or income from the sale of capital assets is subject to the income tax and must be included in the return of corporations.

Sales of
Property
Acquired
Prior to
March 1st,
1913

For the purpose of ascertaining the gain derived from the sale or other disposition of property, real, personal or mixed, acquired before March 1, 1913, the fair market price or value of such property as of March 1, 1913, shall be the basis for determining the amount of such gain derived.

For method of computing profit or loss on properties acquired prior to March 1, 1913, see page 23.)

Interest on
Sinking
Funds

Interest received on sinking funds or from any investment of reserve funds, shall be accounted for as income.

Income of
Real Estate
Development
Corporation

A real estate development corporation, ordinarily, does not realize a profit until the property or properties of such company have been developed. During the time of such development certain carrying charges are incurred, as interest, taxes, insurance, etc. Inasmuch as it would work an injustice to compel such company to deduct carrying charges as current expenses during the period of development, when the property derives no profit, it has been ruled that all such carrying charges may be added to the cost of the property. During the time of development the income from the sale of lots, or parcels, may be deducted from the total cost of land, including the initial cost plus carrying charges and the corporation will return no profit until the amount of sales, or contracts of sales, exceed the prime cost of property plus carrying charges.

In the case of a contract of sale of land on the installment plan of payments by a development company, the gross amount to be paid by the installment purchaser is deemed income and is returnable, for income tax purposes in the year that the contract of sale is made. Should the purchaser default in payment, the amount of such default may be deducted as a loss sustained by reason thereof.

**Income
Instalment
Businesses
Generally**

Corporations and individuals selling merchandise on the installment plan, or on "lease contracts," are required to make their returns of gross income on the basis of the gross amount of contracts of sales made during the year. In other words, the gross amount to be paid by the customer under a contract for the sale or "leasing" of merchandise is construed to be the amount on which the gross profit is computed for income tax purposes. Uncollected accounts, less salvage value of goods returned, if any, may be charged at the end of the year as bad debts. This principle is applicable to all kinds of installment businesses, as, for example, piano, furniture, clothing concerns, etc.

**Premium
Sale
of Capital
Stock**

"The amount received by a corporation for the original issue and sale of its capital stock is held to be the capital of the corporation. In cases where the stock, as originally issued, is sold at a price greater or less than the par value, neither the premium nor the discount will be taken into account in determining the net income of the corporation for the year in which the stock is sold. This is purely a capital transaction and the income is neither increased nor decreased by reason of the sale, *per se*, of the stock at a price greater or less than its par value." (T. D. 2090.)

**Assessment
of Paid-up
Capital
Stock Not
Income**

"Where a corporation sustains a deficit (impairment of capital) at the close of a year, which the stockholders propose to make good by voluntary contribution, such contribution or assessment is not income to the corporation. In a letter to Dorman & Dana, New York, dated February 21, 1916, Commissioner W. H. Osborn expressed himself as follows: "It is therefore the present opinion of this office that the amounts paid by the stockholders pursuant to this so-called voluntary assessment, are to all intents and purposes, if not in fact, additional payments for the stock which they hold, that is to say, such payments are simply an addition to the capital

stock of the company. Since amounts paid for or on account of capital stock issued do not constitute income within the meaning of the Federal income tax law, it is held that these payments represent voluntary assessments upon the stock held by the individual stockholders and do not constitute income to be returned for the purpose of the income tax."

XIII. DEDUCTIONS ALLOWED TO CORPORATIONS.

Deductions Allowed Corporations

"All the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties" are deductible from gross income of corporations.

Losses Deductible

All losses actually sustained and charged off within the year, not compensated for by insurance or otherwise, are deductible items.

Loss Deductible Only in Year Sustained

Losses not compensated by insurance must be deducted from the return of net income for the year in which the loss was sustained. This ruling has been upheld by the courts and is strictly enforced.

Profit or Loss on Property Acquired Before March 1, 1913

For the purpose of computing the profit or loss from the sale of property of a corporation, acquired prior to the incidence of the law, March 1st, 1913, such properties shall be valued as of that time at the fair market price thereof. This applies to both real and personal property.

Depreciation Deductible

A reasonable allowance for the exhaustion, wear and tear of physical properties of a corporation arising out of its use or employment in the business or trade is deductible in the year that such depreciation is sustained. The amount deducted must be actually charged off upon the books of the corporation. (See "Depreciation," page 68.)

**Depletion
of Oil and
Gas Wells**

This deduction is considered in Chapter IV on Depreciation, page 75.)

**Depletion
of Mines**

Under the amended law the provision of the income tax act of 1913, limiting the charge for depletion of mines to "5 per cent. of the gross value at the mine of the output for the year" has been repealed, and there has been substituted the provision that a reasonable allowance for depletion thereof will be permitted, "not to exceed the market value in the mine of the product thereof, which has been mined and sold during the year for which the return and computation are made" under rules and regulations to be prescribed by the Secretary of the Treasury.

Inasmuch as the operating conditions of mines are so materially different, the rate of depletion should be computed on a basis that will provide for the particular requirements of each case. The rules and regulations mentioned in the law may be had upon application to the Commissioner of Internal Revenue, Washington, D. C.

**Depletion
of Timber
Lands**

The rate of depreciation on timber lands by reason of depletion of such properties, may be such as to return to the corporation, or individual, when the timber has been exhausted, the capital originally invested, or in case of purchase made prior to March 1st, 1913, the fair market value as of that date.

Bad Debts

The income tax law does not provide specifically, with respect to corporations, for the deduction of bad debts or uncollectible accounts. The officers of the Government, however, having the administration of the law in charge, have ruled that the same may be deducted as losses. (See page 103.)

**Reserves
for Bad
Debts**

To provide for doubtful and anticipated bad debts, by establishing a reserve for that purpose, has always been considered good accounting practice, but such reserve is not deductible from an income tax return. Ac-

counts receivable, to be deductible from income, must actually have been ascertained to be worthless. Besides, an account, to be deductible, must be actually written off in the period for which it is deducted.

**Reserve
Insurance
Companies**

Amounts added to reserve funds of insurance companies, as required by law, are not deductible from a return of net income.

**Contingent
and Secret
Reserves**

Reserves set aside for contingencies, or so called "secret reserves" are not deductible from returns of annual net income. Charging capital expenditures to operating expenses is specifically prohibited.

**Suspense
Items**

Items held in suspense, pending an event, are not deductible from income for income tax purposes.

**Sinking
Fund
Reserves**

Amounts set aside out of profits, or reinvested, for the purpose of redeeming outstanding bonds payable, are not deductible from taxable income. The redemption of bonds is a capital expenditure.

**Reserve
for
Discounts
on Sales**

Discounts on sales of commodities dealt in are only deductible to the amount actually allowed to customers. A reserve for cash discounts, the establishment of which is approved by modern accounting, being anticipatory and not actual, is not deductible from income.

**Interest
Deductible**

A corporation is allowed as a deduction interest paid within the year on such an amount of indebtedness as does not exceed the sum of:

- (a) The entire amount of the paid-up capital stock outstanding at the close of the year, or if no capital stock, the entire amount of capital employed in the business at the close of the year, and
- (b) One-half of its interest-bearing indebtedness then outstanding.

This subject is more fully dealt with on page 93.

**Interest on
Indebtedness
Secured by
Collateral,
etc.**

The interest paid during the year on indebtedness wholly secured by collateral, the subject of sale in the ordinary business of a corporation, joint-stock company or association, is deductible as an expense of doing business. Collateral, which may be the subject of sale in the ordinary business of a company, refers to commodities in which the company deals. Real estate, in this sense, could only be the subject of sale in the case of a corporation engaged in the buying and selling of real estate. This applies to both tangible and intangible property secured by collateral, but limits the amount of indebtedness on which the interest may be computed to the actual value of such property collateral.

In the case of *Anderson vs. Forty-two Broadway Co.* (209 Fed. 991 and 213 Fed. 777 reversed by U. S. Sup. Ct. Oct., 1915) (T. D. 2261), it was held under the Corporation Excise Tax, that a real estate company owning and operating an office building, under mortgage, could not deduct the interest paid on such mortgage as a general expense, under item 4 (a) (Form 1031) but only in item 6 (a), which made it subject to the limitation of law as to deductibility of interest. For limitation of deductible interest under present law see page 93.

**Interest on
Preferred
Stock**

Interest on any form or class of capital stock is not deductible from an income tax return. The fact that preferred stock is "guaranteed" or cumulative as to interest, does not make it deductible.

**Interest on
Bonds of
Corporation**

Interest paid on outstanding bonds of a corporation is deductible in item 6 (a) of Form 1031 Revised. Where bonds are held by trustees, however, for the benefit of the issuing corporation, interest paid thereon is not deductible.

**Amortization
of Discount
on Bonds**

"In the case of a corporation selling its own bonds at a discount, the amount of the discount should be pro-rated over the life of the bonds and the proportionate part of such discount applicable to each year during the

life of the bonds, constitutes an allowable deduction from the gross income of such year. The deduction from gross income in the case of twenty year bonds, would be one-twentieth of the aggregate amount of the discount on the bonds sold." (T. D. 2137.)

Where, however, bonds were sold at a discount prior to the incidence of the income tax law, and such discount had been charged off on the books of the corporation, then such discount or any part thereof, shall not again be deducted from the gross income.

**Premium
on Bonds
Purchased**

In cases where bonds are purchased at a premium, such premium may be prorated over the remaining life of the bonds, so that only the redemption value thereof appears upon the books when the bonds mature.

**Organization
Expense**

The organization and incorporation expenses of a new enterprise are usually charged to a separate account in the ledger. If such expenses amount to a considerable sum it is not unusual to prorate the same over a period of years, according to the judgment of the board of directors. There appears to have been no ruling upon the acceptability of this method to the Treasury Department. Although the law specifically limits deductions to "the ordinary and necessary expenses paid within the year in the maintenance of its business and operations," it may reasonably be assumed, by analogy, that such expenses may be apportioned over a period of time. The account is, properly, a prepaid expense (sometimes called deferred asset) and in character, is quite similar to prepaid expenses that are proratable over fiscal periods.

**Local
Benefits**

Taxes for grading of property, paving, sewerage and similar local improvements are capital expenditures and not deductible from income.

**Taxes Paid
by Tenant**

Taxes paid by a corporation as tenant of rented property should be deducted in the return as rent paid.

**Bonuses,
Gratuities,
Gifts**

Bonuses in the nature of gratuities for which no service is rendered are not deductible, but bonuses paid in the nature of compensation for extra services rendered are deductible. See page 100.

**Salaries of
National
Guardsmen**

A corporation continuing to pay the salary of an employee doing duty as a National Guardsman in the service of the United States is permitted to deduct the salary paid to such employee in its return of annual net income.

Pensions

Amounts paid to retired employees or to their families, or those dependent upon them, in the nature of pensions, are deductible from gross income as expenses.

**Income
Tax Paid**

Income tax paid is deductible as taxes in the year paid.

**Salesmen's
Expenses**

It has been held that salesmen's expenses in the nature of entertainment of customers, incurred for business purposes, are deductible items.

**Defalcation
Embezzle-
ment**

Losses sustained by reason of defalcation or embezzlement are deductible items. It has been held, however, in the case of *United States vs. The Cleveland, Cincinnati, Chicago and St. Louis Railway Co.*, decided February 23, 1916, in the U. S. District Court, Southern District of Ohio, that such losses shall be deductible only in the year that the defalcation or embezzlement occurs. Should such loss or losses not be discovered until a subsequent year they would not then be deductible. "The time of discovery of a loss bears no relation to the date the loss was sustained. The loss was sustained when the theft occurred, although the defendant did not know at the time of the depletion of its assets."

**Deductions
Allowed
Foreign
Corporations**

A foreign corporation is allowed to deduct: All ordinary and necessary expenses actually paid within the United States; losses actually sustained within the year in its business or trade, within the United States, not compensated for by insurance, or otherwise; also, reason-

able allowance for depreciation and depletion of properties within the United States.

The deductions allowed to foreign corporations as necessary expenses, actual losses, depreciation and depletion, are the same as those allowed to a domestic corporation, except that only such expenses, losses, depreciation, depletion, etc., as occur in connection with the business of such foreign corporation within the United States are allowed.

The provisions with respect to permanent improvements, betterments and expense of restoring property, are applicable to foreign corporations.

The amount on which interest is allowed to foreign corporations shall not exceed such part of the entire paid-up capital stock outstanding at the close of the year, and one-half of its interest-bearing indebtedness then outstanding, "which the gross amount of its income for the year from business transacted and capital invested within the United States bears to the gross amount of its income derived from all sources within and without the United States."

Taxes paid by a foreign corporation within the United States are deductible, not including those assessed against local benefits.

CHAPTER IV

DEPRECIATION

Depreciation Deductible from Income

Depreciation is a deductible allowance in the ascertainment of net income for tax purposes. It should represent, as nearly as possible, the actual deterioration of such physical properties as are susceptible of wear and tear and decrease in value by the efflux of time.

In a broad sense of the word depreciation means a reduction in value and may be applied to all kinds of property. As used in the income tax law, however, it is applicable only to tangible property, such as is "subject to wear and tear, exhaustion and obsolescence." Hence, depreciation will be allowed as a deduction from revenue only on physical properties, such as buildings, fixtures, machinery, etc. All depreciation to be deductible must be actually charged off in the books of account in the period for which it is claimed.

Methods of Computing Depreciation

There are several methods of computing rates of depreciation, the most common of which are:

1. By equal instalments.
2. On diminishing values.

The first method is ordinarily used where the property depreciated has no residual value, and the second one where the property has a residual value. Charging off equal instalments is most commonly employed with respect to all properties, whether they have a residual value or not, and only that method has as yet been suggested or approved by rulings of the Treasury Department or court decision in connection with deductions from income tax returns.

In a publication issued by the Federal Trade Commission recently, on the subject of "Fundamentals of a Cost System for Manufacturers," both methods are

approved in the following language: "There are several methods of determining the amount of depreciation. One is to estimate the scrap value and deduct this figure from the original cost. The difference is then divided by the estimated life of the machine in years, and the result is the annual depreciation on that machine. A modification of this method which is not quite as simple, but really affords no difficulty, is after ascertaining the amount to be charged off during the life of the machine, to determine a percentage which, when applied to the net book value of the machine, will leave only the scrap value of the machine on the books at the expiration of its estimated life.

"To illustrate: If the initial cost of a machine and equipment is \$1,000 and the estimated scrap value is \$200, with an estimated life of ten years, then \$800 is the amount that must be charged into cost during that period, or \$80 per year. To attain this result, by using the net value of the machine as a basis, a rate of 15 per cent. would be necessary, which would make the depreciation 15 per cent. on \$1,000, or \$150 the first year; 15 per cent. on \$850, or \$127.50 the second year, etc. The advantage of this method in the interest of normal costs is, that the decrease in depreciation charges is ordinarily offset by an increase in repairs."

Where reserves for depreciation are used in conjunction with the "Diminishing Value Method" the amount of the reserve set aside in past periods should be deducted from the asset account before the depreciation is computed thereon.

Reserve for Depreciation

The most approved method of double entry bookkeeping favors the establishment of reserves for depreciation instead of reducing the balances of the asset account in the ledger. This is accomplished by journal entry, made either monthly or at the end of the fiscal period, just prior to closing the books of account, as follows:

Depreciation	\$250.00	
To Reserve for Depreciation of Furniture and Fixtures		\$250.00
Depreciation at 10% per annum on Furniture and Fixtures for the year 1916. (Book value—cost —\$2,500.)		

The Depreciation Account is closed into Profit and Loss Account and the Reserve for Depreciation, a negative account,¹ remains open. In the Statement of Assets and Liabilities the Reserve for Depreciation is deducted from the asset account and extended at the net amount, as follows:

Furniture and Fixtures.....	\$2,500 00	
Less Reserve for Depreciation (10%)	250.00	
	<hr/>	\$2,250.00

Although not essential, it is advisable to keep a separate reserve account for each class of assets, as: Reserve for Depreciation of Furniture and Fixtures, Reserve for Depreciation of Machinery, Reserve for Depreciation of Buildings, etc. This separation renders more accessible the amount of deduction from the respective asset accounts, when preparing the balance sheet.

Diverting Reserves

A Reserve for Depreciation must be kept separate and distinct from other reserve accounts and reserve funds. A reserve fund is an amount set aside for the purpose, among others, of providing an available asset (cash or readily convertible investment) for a present or future obligation, as a renewal of plant and machinery. The creation of such fund does not incur the reduction of surplus or profit because it is not an expense; it is not created by a reduction of revenue, but merely a conversion of profits or surplus. Hence, a reserve fund set aside for amortization of bonds, or to provide quick

¹ A negative account is one that is neither an asset nor a liability; it qualifies an asset account, as, for example, Furniture and Fixtures.

assets for any other purpose, is not a competent deduction in an income tax return. Nor are reserve accounts properly deductible except in so far as they are a reduction of the value of an asset. A reserve account appearing on the liability side of a balance sheet, unless represented by a specially invested fund in the assets, is offset by all the assets in the balance sheet. But a "Reserve for Depreciation" is, technically, neither a reserve fund nor reserve account, because it has been charged against revenue and has reduced the surplus. To be a true reserve it should not reduce the revenue or surplus. Therefore, a "Reserve for Depreciation" is nothing more than an "allowance for depreciation" and should never be stated on the liability side of a balance sheet. It is nothing more than a negative account, a reduction of the book value of a particular asset, and should be deducted in the Statement of Assets and Liabilities from the asset to which it refers.

Hence, under rulings in connection with the income tax, a so-called "Reserve for Depreciation" shall not be diverted to any purpose except "making good the loss sustained by reason of wear and tear, exhaustion or obsolescence of the property with respect to which it was claimed."

Depreciation may only be charged off up to the cost of the property depreciated. Should depreciation, for any reason, have been charged off in excess of such amount, then such excess shall be reported as income (Art. 132, Reg. 33).

Rates of Depreciation

The law does not prescribe rates of depreciation because these depend upon the kind and class of property, and upon the conditions under which the property is used. Fixing rates of depreciation is more or less arbitrary at best.

The fairness of rates of depreciation, deducted in returns of net income, are questions of fact, and not of law; that is to say, such questions at issue in a court

of law would, ordinarily, be submitted to a jury for determination.

Technical rate fixing is a question on which there are diversified opinions, even amongst the best engineers. But engineers have suggested rates for various classes of properties that work out fairly accurately for all practical purposes. The rates mentioned herein are suggestive only. They are based upon the experience of engineers and accountants.

Buildings

In the case of *Hyman Cohen vs. John Z. Lowe, Jr.*, Collector (decided July 18, 1916), tried before a jury in the United States District Court for the Southern District of New York, Judge Grubb stated that, in his opinion, depreciation on a building should be based upon the number of years "the building would remain in a condition to be habitable for the uses for which it was constructed and used * * *. The annual depreciation would be an amount represented by a fraction having one (the tax year) for the numerator and the number of years, representing the ascertained life of the building, as the denominator." Hence, a building, estimated to remain habitable and fit for the purposes for which it was erected for a term of forty years, would suffer an annual depreciation of $2\frac{1}{2}$ per cent. In the Cohen case, just cited, the plaintiff (owner of building) claimed a depreciation of 5 per cent. for the tax year (1913). The Collector of Internal Revenue allowed only 3 per cent., and the plaintiff brought an action to enforce his claim of 5 per cent. The jury brought in a verdict that they considered 3 per cent. an adequate allowance. The building in question was a New York apartment house.

Depreciation is allowed only on the cost of buildings and improvements, not on the land. For depreciation and other purposes, buildings and land should be carried in separate accounts in the ledger. If the separate cost of buildings, as apart from the land, is not ascertainable, then the separate value of improvements, as shown by

the real estate tax assessments, may be used, or, the value of buildings and improvements may be estimated as at March 1, 1913, if then in existence, "provided that the value placed upon such buildings shall not be in excess of the cost of such buildings, less an amount measuring the depreciation which had previously been sustained."

To measure the fairness of the amount on which depreciation has been deducted on buildings, in returns of net income, Internal Revenue Inspectors have made comparison with the amount of fire insurance carried thereon. But that, for obvious reasons, is not a fair comparison.

The question of rate of depreciation must always be determined upon the conditions governing each particular case. The rate on brick buildings varies from $1\frac{1}{2}$ to 5 per cent. per annum, according to construction and use to which buildings are put. A factory building, wherein manufacturing of heavy machinery is carried on, may suffer a larger depreciation than 5 per cent. per annum.

It is reasonable to assume that frame buildings are subject to a larger rate of depreciation than brick or concrete buildings, because of having a shorter period of usefulness. The rates on frame buildings will vary from $2\frac{1}{2}$ to $7\frac{1}{2}$ per cent., according to construction and uses, and may run higher in some cases.

Building Repairs

In estimating the life of a building for the purpose of determining upon a rate of depreciation, it must be assumed that the property is maintained in proper repair. The cost of repairs and expenses of upkeep are deductible items in a return of net income.

Additions Betterments

Additions to buildings or any expenditure that constitutes an increase in the investment therein, such as permanent improvements and betterments, are not deductible.

Additions to Leased Property

A person or corporation holding premises as lessee, for a term of years, requiring the tenant by terms of the lease to make all repairs and improvements, if any, has

the right to deduct the improvements as well as repairs from his or its gross income. Such improvements should be prorated over the period of the lease. The repairs, however, may be deducted as current expenses.

**Buildings
Erected
by Tenants**

The cost of buildings erected by tenants on leased ground, which, upon expiration of the lease, revert to the landlord, may be prorated over the period of the lease and deducted as an expense of doing business. The amount charged off (prorated) should be deducted in the return of net income of a corporation as rent paid.

**Furniture
and
Fixtures**

Ordinarily business concerns capitalize amounts paid for furniture, fixtures and office equipment; that is to say, they establish a Furniture and Fixture Account in the ledger and charge purchases of that class of assets to such account. This class of property depreciates from 5 to 25 per cent. per annum; 10 per cent. is the usual charge where renewals are added to the account.

An uncommon practice is to charge off the entire cost of renewals of furniture and office equipment as a cost of doing business. This method, in the case of *Mutual Benefit Life Insurance Company vs. Herold* (198 Fed., 199) was approved. It was there held that "Renewals of office furniture and equipment" were "expense of maintenance" deductible in the ascertainment of net income. As this decision deals only with "renewals" of such equipment it would not apply to the first cost.

Furniture, fixtures and office equipment should be carried in a separate ledger account from office supplies. Office equipment represents a fixed asset, whereas office supplies is an expense account.

Dwellings

Depreciation on a dwelling (residence) occupied by the owner himself is not deductible; on dwellings that are held for investment, however, by both individuals and corporations, a reasonable charge for depreciation is allowed.

"Reasonable allowance for the wear and tear of

property arising from its use for rental purposes may be claimed as a deduction, but no claim for depreciation should be made on account of any amount of expense of restoring property or making good the exhaustion thereof for which a deduction is claimed elsewhere in the return." (Letter by Commissioner of Internal Revenue to the Corporation Trust Co., Feb. 26, 1916.)

**Farm
Buildings**

Depreciation on farm buildings, other than those occupied by the owner himself, may be deducted from income. (T. D. 2090.)

**Depletion
of Mines**

A reasonable allowance for depletion of mines, not to exceed the market value in the mine of the product thereof which has been mined and sold during the year for which the return and computation are made, will be allowed. When the allowance authorized shall equal the capital originally invested or in case of purchase made prior to March 1, 1913, the fair market value as of that date, no further allowance for depletion shall be made.

**Depletion,
Oil and Gas
Wells**

In the case of oil and gas wells a reasonable allowance for actual reduction in flow and production to be ascertained not by the flush flow, but by the settled production or regular flow. As in the case of mines, when the allowance authorized for depletion shall equal the capital originally invested, or in case of purchase made prior to March 1, 1913, the fair market value as of that date, then no further allowance shall be made.

**Timber
Lands**

The rate of depreciation on timber lands should be such as to return to the owner, when the timber has been exhausted, the capital originally invested therein, except if the property was acquired prior to March 1, 1913, the fair market value as of that date.

Machinery

There are so many different classes and kinds of machinery that it would be well nigh impossible to fix a rate of depreciation that would uniformly apply to all classes. L. R. Dicksee, an English accountant of recognized

ability, in his work on "Depreciation, Reserves and Reserve Funds," has suggested annual rates of depreciation on machinery, based on diminishing values, as follows:

General machinery $7\frac{1}{2}$ to 10 per cent.
 Special machinery 10 to 25 per cent.

To facilitate the computing of depreciation on a variety of classes of machinery, it is advantageous to classify them according to expected life, and then to compute the depreciation on each class accordingly.

The scrap or residual value of machinery should be taken into consideration in arriving at rates of depreciation.

Boilers Engines

There is a diversity of opinion as to the rate of depreciation to which engines and boilers are subject. Dicksee suggests annual rates, on a diminishing value, as follows:

Engines (in general) 10 to $12\frac{1}{2}$ per cent.
 Boilers $12\frac{1}{2}$ to 20 per cent.

George M. Craven, whose tables of depreciation have been adopted by commissions passing upon rate cases, and who errs on the conservative rather than the liberal side, based on cost (not diminishing value) per annum, suggests the following rates:

Steam engines 3 to 6.6 per cent.
 Boilers 3.5 to 10 per cent.

Composite opinions, however, are that engines and boilers, if maintained in a proper state of repair, which necessarily must be assumed, should last, in the absence of unfavorable conditions, about ten years, and would be subject to an average depreciation of 10 per cent. per annum. If unfavorable conditions prevail, they would naturally be replaced oftener and the rate of depreciation would be proportionately higher.

Repairs

Replacements

Article 131 of Treasury Department Regulations No. 33 states that "Incidental repairs which neither add to the value of the property nor appreciably prolong its

life, but keep it in an operating condition, may be deducted as expenses." Notwithstanding the apparent clearness of this regulation, there have been many controversies between Collectors of Internal Revenue and taxpayers as to what constitutes "incidental repairs." Rulings on the subject have recommended the establishment of reserves for depreciation and directed that to such reserve accounts should be charged "the cost of renewing or replacing the property with respect to which the depreciation is claimed." But it is not intended that "incidental repairs" that merely "keep it in operating condition" shall be so charged, because, under the above regulation, such expenses are separately deductible from income.

The main object and purpose of charging off depreciation is not to provide a fund out of which to make repairs, but in the case of a machine, for example, to provide for the replacement of such machine when it has served its usefulness.

The income tax law contemplates more than a mere renewal and repair reserve because it specifically permits the deduction of "All the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties * * *," as well as "a reasonable allowance for the exhaustion, wear and tear of property arising out of its employment in the business or trade." These are separate and distinct provisions, first for necessary expenses, which must include repairs, and, second, for depreciation.

It may be true in respect to a machine, or any other property, which is periodically wholly rebuilt, that the depreciation is very small, but that it suffers some degree of depreciation is axiomatic. Whether, however, the cost of such renewals should be charged to the reserve for depreciation or to an expense account, should depend upon the adequacy of the rate of depreciation charged off. Hence, in fixing upon rates of depreciation

it should be predetermined whether renewals will be charged against the reserve for depreciation or to an expense account. Regardless of which method is adopted the accumulation of depreciation reserved should be such an amount as will return to the corporation or individual the cost of the property upon the termination of its usefulness.

Shafting

Shafting, based upon a diminishing value, has been estimated to suffer depreciation at the rate of 5 to 7½ per cent. per annum.

Tools

Small tools should be charged to a separate account in the ledger. Physical inventories should be taken periodically and the account written down to the amount of such inventory. The difference between the book value and the physical inventory value should be charged to depreciation, and in the course of time it should be possible to determine upon an average rate of depreciation that will answer all practical purposes. Such average rate should, however, from time to time, be verified by physical inventories. This principle may be applied to all items that are being constantly used up and replaced.

Miscellaneous Equipment

In as much as the rates of depreciation suggested by Craven have been adopted by various industrial concerns and commissions, they are worthy of consideration. They are, however, by many, considered too low and are stated here only as suggestive of the most conservative annual rates:

Shop Equipment	3 to 15	per cent.
Motors	4 to 10	per cent.
Storage Batteries	5 to 11	per cent.
Belted Generators	3.3 to 10	per cent.
Switchboards, etc.	2 to 10	per cent.
Wires and Cables	2 to 6.6	per cent.
Steam Piping	3.5 to 10	per cent.
Steam Turbines	5 to 9	per cent.
Auxiliaries	5 to 10	per cent.

**Laundry
Equipment**

The equipment of laundries is, ordinarily, subject to an annual depreciation of from $7\frac{1}{2}$ to 15 per cent. of the cost.

Patterns

Patterns are made of so large a variety of materials and used so differently, that each case will have to be decided according to the particular requirements. Patterns that are continuously used and must be replaced often may properly be charged off at once as a cost of production. Special patterns should always be charged direct to the job for which they were made.

Dicksee suggests annual rates, based on diminishing values, of 25 to $33\frac{1}{3}$ per cent.

But there can be no obligation on the part of the manufacturer to capitalize any expenditure unless it is unquestionably a capital expense.

Accountancy maintains (some accountants to the contrary notwithstanding) that where there is a reasonable doubt as to whether an expenditure is a capital or expense item, it should be charged against revenue. That precludes questionable items entering a balance sheet, and indicates a business policy with which no law should be at variance.

Patents

Patents are issued in the United States for a period of seventeen years. It is customary for manufacturing corporations, operating under patent rights, to capitalize all direct expenses in connection with obtaining patents either by their own application to the Patent Office or by purchase.

In case the corporation itself procures the patent, it has the right to deduct depreciation annually at the rate of $1/17$ of the total cost, including experimental work, cost of models and drawings, fees of the Patent Office, legal expenses, and all direct charges in connection therewith.

If the patent is purchased by the corporation, then the depreciation would be based on the cost thereof and

the rate would be fixed according to the length of time that the patent had still to run; for instance, a patent purchased for \$10,000, that had been issued seven years prior to its purchase, having a remaining life of ten years, would be subject to an annual depreciation of 10 per cent. of the cost, amounting to \$1,000. This amount would be a competent annual charge against gross income.

Copyrights

The principles stated with respect to patents are true also as to copyrights, except that copyrights are issued for the period of twenty-eight years. A more conservative method, in the case of copyrights, however, is to estimate the period of salability of the subject of copyright and prorate the amount to be charged off accordingly.

Auto Trucks

Automobile trucks deteriorate according to the severity of the use to which they are subjected. The life of a motor, used for trucking purposes, receiving reasonable care and properly maintained, may be estimated to be from three to six years. As with other property, the rate of depreciation is fixed according to its life. The life of an auto truck is such a length of time as it remains fit for the purpose for which it was acquired.

The annual rate applicable to auto trucks will vary from 15 to 50 per cent. Based on a replacement value, the heaviest depreciation occurs during the first year, and it is not uncommon to write off as much as 50 per cent. of the cost during that time. Thereafter the rate would not exceed 25 per cent. per annum.

The most accurate and conservative method is to appraise motor trucks at the end of each year and to write off the shrinkage in value during the year for which the return of net income is computed. This method, being based on actual facts, cannot be objectionable for income tax purposes.

All costs of repairs, replacements or parts, tires, over-

hauling, painting, supplies, gas, oil, licenses and insurance, in connection with auto trucks are deductible expenses in the return of net income.

Horses
Stable
Equipment

Depreciation on horses varies so widely that each concern should work out its own table of experience for depreciation purposes. Rather than to guess at an arbitrary rate of depreciation, it is advisable to revalue horses at the end of each fiscal period. The loss in value during the tax year may then be deducted as depreciation, and, in the course of time, it will be possible to formulate, fairly accurately, the rate of depreciation to which horses, in the particular business, are subject. It may be said that, ordinarily, the rate of depreciation on horses will vary from 15 to 25 per cent. of their cost.

Stable equipment usually suffers a depreciation of from $7\frac{1}{2}$ to 15 per cent. per annum.

Good Will

Depreciation on good will is not allowed, because it is an intangible asset that cannot suffer loss by reason of "wear and tear" or "obsolescence." From an accounting point of view, the practice of "writing down" the book value of good will is not an unusual one in periods of prosperity. Its purpose is, primarily, to reduce the book assets to tangible properties and thereby give the balance sheet a healthier appearance. The practice, although commendable, and perhaps a sign of conservative management, does not permit of a deduction in the income tax return. As a matter of bookkeeping, such a charge would be a reduction of Surplus Account and not of Profit and Loss Account for any particular period of time.

No rule for charging off good will can be laid down, because in a flourishing business, the good will is of proportionate value and should not, in theory, be reduced; whereas, in periods when no profits are being earned, the value of good will diminishes, but then there is no profit out of which to reduce the Good Will Account.

Hence, at best, the reduction of good will is a purely arbitrary matter that bears no relation to an income tax return.

Investments**Stocks and Bonds**

Stocks and bonds fluctuate in value. A downward fluctuation, if permanent, may be said to be depreciation, but such is not deductible for income tax purposes. Losses to become deductible must be actually sustained by completed and closed transactions. A mere reduction in book value by direction of a board of directors, or even an order by the State or Federal Banking Department, to reduce or write off securities, does not establish a loss that constitutes a deduction from taxable income. "Losses of this character are only ascertainable when the securities mature, are disposed of, or canceled." (T. D., 2152.)

No arbitrary reduction of capital assets on the books of a corporation or individual shall justify a deduction from income for tax purposes. Conversely, the appreciating, or "writing up," of capital assets to conform, for instance, with appraisal values, does not make such increase taxable as income. (Baldwin Locomotive Works *vs.* McCoach, 221 Fed., 59.) There must be an actual realization of the enhanced value by a sale for cash, or its equivalent, in order to make the increase taxable as income.

Theatrical Costumes

Theatrical costumes may be depreciated. The rate should be based on the life of garment or time allowed for production of play, whichever is the shorter. Obsolescence is an important element for consideration in determining the life of a costume. Wearing apparel, serving both the purpose of personal and theatrical use, may not be depreciated for the purpose of income tax.

Trademarks**Brands**

Neither trademarks nor brands, acquired by purchase or otherwise, are subject to depreciation, and no allowance for income tax purposes will be made thereon.

In the case of resale of trademarks or brands, a loss actually sustained would be deductible, as a capital loss. A profit, on the other hand, would be returnable as income.

If the trademark or brand was acquired prior to March 1, 1913, then the profit or loss in the sale thereof would be computed on the basis of the fair market value as of that date and not on the basis of cost. This applies to the sale of all capital assets acquired prior to the incidence of the income tax law, March 1, 1913.

The cost of registering trademarks and brands, being nominal, should be included in the expense of doing business. Should such an item be capitalized it would not be deductible as an expense in a subsequent year.

Stock on
Hand

By rulings of the Treasury Department no allowance for depreciation is permitted on inventories of stock on hand. It has been held "that depreciation will not be allowed in the return or inventory, on merchandise, as the same will be reflected in the income in the year of its disposal." Also, as directed in the supplementary statement of the return, "In case the annual gain or loss is determined by inventory, merchandise must be inventoried at the cost price * * *." This is based upon the theory that no actual loss is sustained until the goods are sold.

These rulings are contrary to the well settled principles of accounting, that when the market value of merchandise is less than the cost, the market value should prevail for inventory purposes.

A merchant who commits an error of judgment in buying merchandise should be permitted to apportion his loss over the periods during which he is obliged to carry the unsalable goods in stock. In some lines of business the ruling will work a hardship. Publishers, for example, who must carry slow selling stock from year to year, a large part of which eventually proves unsalable, will be piling up inflated and exaggerated in-

ventories of stock on hand, if computed at cost. No law should encourage the overstatement of values of assets because such overstatement affects the rights of creditors who rely on the representations of financial statements as a credit basis. Besides, under State laws, the overstatement of assets is punishable as a misrepresentation of facts. Nor is the ruling that inventories must be computed at cost consistent with conservative business methods.

It is noteworthy that the Federal Trade Commission in a pamphlet issued on July 15th, 1916, entitled "A System of Accounts for Retail Merchants" for the purpose of "Aiding retail merchants to improve their accounting methods" on the subject of depreciation, states: "No merchant can be said to be managing his business properly unless adequate provision is made for depreciation." As to depreciation on merchandise, under the title of "Profit and Loss Account" it says: "A physical inventory should be taken at least once a year. The basis should be cost with conservative deduction for obsolete and shelf-worn goods." A perusal of the proforma Profit and Loss Account, contained on page 18 of the pamphlet, discloses a deduction from inventory designated "Less Stock Depreciation" of an amount equal to 5 per cent. of the inventory which concededly was based on cost.

The only danger that the depreciation of inventories would involve in connection with income tax returns, is the possible manipulation of merchandise values. As in the case of depreciation of capital assets, fixed rates could not be prescribed to cover all cases, but manipulation of inventories for the purpose of showing a smaller gross income than was actually earned could be prevented by requiring detailed information as to how the inventory was computed, rate of depreciation deducted, etc.

Until there has been a court adjudication upon the prescribed ruling of computing inventories, stock on hand

should be valued at cost. In cases where the inventory, taken at cost, results in an inflated or overstated "net income," it is recommended that the individual or company aggrieved place all the facts of his or its case in writing before the Commissioner of Internal Revenue, Washington, D. C., or the collector of his or its district, and ask for a special ruling thereon.

CHAPTER V

BOOKKEEPING SUGGESTIONS

PREPARATION OF INCOME TAX RETURNS OF CORPORATIONS

Methods of Bookkeeping

The amended law contains a provision in regard to the keeping of accounts, as follows:

"A corporation, joint stock company or association, or insurance company, keeping account(s) upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect its income, may, subject to regulations made by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, make its return upon the basis upon which its accounts are kept, in which case the tax shall be computed upon its income as so returned."

The same provision is made with respect to the accounts of individuals.

This permits the individual or corporation, that employs a method of bookkeeping from which a return cannot be prepared in the prescribed form, to render the report according to the method of bookkeeping employed, provided only that the books from which the return is made reflect the correct income. The return, however, must, in every case, be made on the blank provided by the Government, with full and complete explanations as to the method employed.

The dominant and foremost requisite in the preparation of income tax returns is TO REPORT THE FACTS. The method employed to arrive at the facts is of considerable importance, but secondary. A variance from the prescribed classification of income and expenses may be unavoidable; a deliberate disregard of the facts, by either omission or declaration, is tantamount to misrepresentation.

The income and expenses should be classified as prescribed by the return unless the nature of the business is such that it does not permit of such classification or unless the books of account are kept in conformity with regulations of some department of the Government requiring the keeping of books according to "uniform systems of accounting," as in the case of corporations coming under the Interstate Commerce Commission.

The books must be so kept that each and every item set forth in the return of annual net income may be readily verified by an examination of the books of account.

**Books of
Account Best
Guide to
Income**

"The books of a corporation are assumed to reflect the facts as to, its earnings, income, etc. Hence they will be taken as the best guide in determining the net income upon which the tax imposed by this act is calculated. Except as the same may be modified by the provisions of the law, wherein certain deductions are limited, the net income disclosed by the books and verified by the annual balance sheet, or the annual report to stockholders, should be the same as that returned for taxation." (Regulations 33, Article 183.)

**Examination
of Books
by Internal
Revenue
Officers**

"For the purpose of verifying any return, made pursuant to this act, the Commissioner of Internal Revenue may, by any duly authorized revenue agent or deputy collector, cause the books of such corporation to be examined, and if such examination discloses that the corporation is liable to tax in addition to that previously assessed, or assessable, the same shall be assessed and shall be payable immediately upon notice and demand. For the purpose of such examination, the books of corporations shall be open to the examining officer, or shall be produced for this purpose upon summons issued by any properly authorized officer." (Regulations 33, Article 186.)

Accruals
Prepay-
ments

Although there has, as yet, been no ruling upon any phase of accounting under the present income tax law, it is clear that corporations or individuals keeping accounts upon the plan of accruing income and expenses or deferring prepayments, may now prepare their returns accordingly. From an accounting viewpoint this is the only correct method whereby the true profit or loss of a business may be deduced. But the method, if employed, must be used consistently and with limitation. In no case shall an expense account for a tax year or fiscal year be charged with a greater amount than is actually incurred or accrued therein and for which the business has received value in such fiscal or tax year; that is to say, no deduction shall be made of an amount in excess of that actually chargeable against the operations of the year (fiscal or calendar) for which the return is made. Prepayments may be deferred, that is, such part of expenses as are prepaid may be deducted from expenses and treated as "deferred assets" or "prepayments" in the balance sheet.

The accounts most commonly accrued or deferred are interest, taxes, insurance, rents, salaries, commissions and income taxes withheld, but the principle is applicable to all classes of income and expenses.

No accruals shall be deducted from income unless they appear upon the books of account and represent expenses actually incurred or accrued during the year.

Wherever the expressions "actually paid" or "paid during the year" appear herein, when applied to individuals or corporations keeping their accounts upon the "accrual basis," such accruals are comprehended therein.

Distribution
of Accounts

Apart from facilitating the preparation of income tax returns, bookkeeping suggestions would be out of place here. But a great deal of time and work may be saved to the bookkeeper and to the executive who is responsible for the contents of the report, by employing a method of bookkeeping that will, without analysis of accounts,

present to immediate view in a trial balance, the component parts called for by the income tax return. This can be accomplished only by a suitable distribution of accounts of income and expenses, assets and liabilities.

Sales

Merchandise sales should be credited to a separate account in the ledger. Where departmental accounts are kept, the ledger should contain a separate sales account for each department or each class of commodity. The sales called for by the supplementary statement of the income tax return under "Gross Income from Operations" should be the net sales, *i. e.*, gross sales (amounts charged to customers) less returns, allowances and discounts allowed on sales.

**Return
Sales**

Goods returned by customers should be charged to a separate account unless they are, in aggregate, so small a proportion of the sales that a separate account would not be justified. If no separate account is kept, the returns should be charged to Sales Account. The advantage of a separation—which bears no relation to the preparation of a tax report—is that a monthly trial balance discloses, at a glance, the proportion of returns to the volume of sales.

As stated under "Sales," goods returned by customers should, for the income tax report, be deducted from amount shown by Sales Account (Gross Sales).

Allowances

Ordinary allowances on goods sold, such as claims by reason of breakage, short shipment, overcharges, defective goods, etc., should be charged to an Allowance Account and deducted from sales for the income tax return. Exceptional allowances, such as unrecovered shipments lost in transit, for which the shipper is responsible and cannot recover from the transportation company, should be charged to an account that by its title is descriptive of its contents, as "Goods Lost in Transit," and should be stated in the income tax return and supplementary statement in item 5 (a). All losses,

to be deductible from the income tax return, must be charged off in the year sustained.

**Discounts
Allowed****Discounts
Received**

"Discounts allowed" on sales should be charged to an account bearing that title. "Discounts received" on goods purchased should be credited to a separate account so entitled. For income tax purposes discounts allowed to customers are a reduction of the gross sales, and discounts received, as a trade allowance or for prepayment of goods purchased, are a reduction of the cost of goods bought.

Rebates

Rebates on sales that are allowed by way of commissions, or as a reward for selling certain quantities of commodities, should be carried in a separate account in the ledger and treated in the income tax return as a general expense under "Deductions" and included in "Commissions" in the supplementary statement, item 4 (a) 1, under "Expenses, General."

Purchases

Merchandise purchased should be charged to a "Purchase Account" in the ledger. As an income tax deduction in the ascertainment of "Gross Income from Operations," there should be added to the purchases all transportation charges paid or incurred thereon. There should be deducted: returns, claims, discounts received and "anticipations" received.

A manufacturing corporation employing a cost system that is an integral part of the bookkeeping system, *i. e.*, where such system is comprehended in the general books of account and included in the general ledger trial balance, may state as "Purchases" the cost of manufactured goods, as derived from such cost system. Mere cost memoranda, data, or books of account, however, that are not subject to proof of correctness, are not sufficiently reliable records from which to prepare income tax returns. It is not necessary that the cost accounts should be kept in the same binder or within the same cover as the general ledger, but, in summary,

the costs should be controlled by general ledger accounts. For further discussion of this subject, see "Manufacturing Corporations Operating Cost-systems," page 110.

Where a cost-system does not answer the requirements of proof as to accuracy of results the form of return (Form 1031) should be adhered to. Corporations doing a mercantile business (buying and selling raw materials or finished products manufactured by others) as well as a manufacturing business, should conform to the classification contained in the return, unless the separate departments are clearly differentiated in the books of account.

**Freight on
Sales**

**Freight on
Purchases**

Transportation charges on goods sold (freight out) should be kept separate from those on goods purchased (freight in). Freight on goods sold, for income tax purposes, is an expense of doing business and should be included in item 4 (a) under "Deductions," and in the supplementary statement in item 4 (a) 7. Transportation charges on goods bought increases their cost and should be added to the cost of purchases. Separate accounts in the ledger should be kept of freight on sales and freight on purchases, to be known, respectively, as "Freight Out" and "Freight In." Items of expressage and cartage may respectively be charged or credited to these accounts. In case where own trucks are used the apportionment may be estimated based upon the cost of stable or auto expenses, labor, etc.

Inventories

Stock on hand should be carried in a separate account in the ledger under the title of "Inventory Account." Where freight and other transportation charges have been added to the purchases, the proportion added thereto should, technically, be included in the inventory. But this would have to be approximated at best, and may, as an expediency, be disregarded except where it is a very material item or where the computation is rendered simple.

For income tax purposes, inventories should be computed at cost and so stated in 3 (a) of supplementary statement of the return. The deduction of depreciation from the cost of commodities dealt in is prohibited. (See "Stock on Hand," page 83.) "No part of the overhead expenses should be added to the inventory."

Care should be exercised to see that the amount of stock on hand reported at the beginning of a tax year is the same amount as that shown as on hand at the close of the preceding year. An increase in the amount at the beginning of a year over that stated at the close of the previous year would result in a decrease in the gross income, which, in the absence of a clerical or technical error, would be *prima facie* evidence of fraud.

Rentals

Rents received should be kept in a separate account from rents paid. Receipts of rent, where the corporation owns the rented property, must be reported as income, whereas rents paid are deductible as general expenses. The amount paid on a leasehold may be prorated over the period of the lease and deducted annually as rent paid during the year. This is also true where a building, reverting to the landlord, is erected on leased land; the annual rate of deduction being the fraction: one, as the numerator, and the number of years of the leasehold, as the denominator, multiplied by the cost of the building and improvements. The cost of such improvements should be charged to a "Leasehold Account" in the ledger and the amount charged off annually should be stated in the income tax return in item 4 (a) 3, under "Expenses, General" in the supplementary statement.

Ordinary rentals paid should also be stated in the supplementary statement under "Expenses, General" in item 4 (a) 3, the total of which appears in the report under "Deductions" in item 4 (a).

Royalties

Royalties received are returnable as income from rentals. Where royalties are both paid and received, it is

advisable to keep a separate account for each in the ledger, designating them "Royalties Received" and "Royalties Paid," because they are separately reported in the return of net income. Royalties paid are returnable under 4 (b) "Payments in Lieu of Rent." Royalties received should be included in item 3 (b) "From Rentals" under "Gross Income."

Interest Received

Interest received and interest paid should be respectively credited and charged to separate ledger accounts, and each of them should be further subdivided according to the separation called for by the tax return, as follows:

Interest received on bonds or other obligations of the United States, or its possessions, from a State, Municipality or other political subdivision, although not subject to the income tax, must be reported as income in 3 (c) of the supplementary statement and should be credited to an account in the ledger entitled "Interest Received on Government Securities."

All interest, other than that received on Government bonds or obligations, except "anticipations," should be credited to a general "Interest Received Account," and should be reported in item 3 (c) under "Gross Income" in the return.

"Anticipations"—interest received for the prepayment of accounts payable—should be credited to "Anticipation Account" and for income tax purposes are deductible from the cost of purchases, the same as are discounts received.

Interest Paid

Interest paid by a corporation should be classified as follows:

1. "Interest paid on indebtedness, wholly secured by collateral, the subject of sale in the ordinary business of the corporation," should be charged to an account entitled "Interest Paid on Secured Debts" and reported in the return under "Expenses, General," item 4 (a) 5 in the supplementary statement.

2. Interest paid on mortgages secured by property which the corporation occupies but does not own and has no equity in, should be charged to "Interest Paid in Lieu of Rent" and stated in the return under "Deductions" in item 4 (b).

3. All interest paid on bonds and other indebtedness should be charged to "Interest Paid Account" and stated in the return in item 6 (a) under "Deductions." The amount of interest deductible under this item is the amount actually paid within the year on an amount of bonded or other indebtedness not in excess of the sum of one of the subdivisions of "A" plus "B":

A. 1. The paid-up capital stock outstanding at the close of the year,

or

2. If the capital stock has no par or nominal value, the amount of cash or its equivalent paid or transferred to the corporation as a consideration for shares issued and outstanding at the close of the year,

or

3. If no capital stock, the entire amount of capital (not including liabilities) employed in the business at the close of the year,

plus

B. One-half of the interest-bearing indebtedness outstanding at the close of the year.

For example, in the case of a corporation having, at the close of the year, a capital stock of \$500,000 and bonded and other indebtedness of \$200,000, the deductible interest, at 6 per cent. per annum, would not exceed:

6 per cent. on \$500,000	\$30,000
6 per cent. on 100,000	6,000
<hr/>	
Total, 6 per cent. on \$600,000	\$36,000

Should the actual interest paid during the year exceed the sum of \$36,000, in the example cited, the excess would not be deductible and only \$36,000 should be entered in item 6 (a) of the report under "Deductions."

In the case of subdivision A, 3, having no capital stock, the "capital employed in the business * * * contemplates the entire capital paid in by the members of the company, including so much of the accumulated surplus as is not in excess of the needs of the business, but does not include any borrowed capital or interest-bearing indebtedness."

In the supplementary statement under item 6 (a) "Interest Deductible" should be listed "all forms of indebtedness upon which interest was paid," stating as to each:

1. Name or kind of obligation (Bonds Payable, Mortgages Payable, Bills Payable, etc.),
2. Amount of principal of each class,
3. Rate of interest on each class,
4. Amount of interest paid on each class of obligations.

Irrespective of the amount deducted in the main report under "Deductions," the amount stated as "interest paid" in the supplementary statement is the total amount paid during the year. The amount deducted cannot exceed the total amount actually paid, but, by the limitation of law hereinbefore stated, may be less.

No dividends or so-called interest on any kind of capital stock are deductible; "guaranteed," cumulative or preferred dividends are no exceptions.

Interest
"Debenture
Bonds"

Interest on any bonds of a corporation secured by mortgage on its real or personal property is deductible in a return of net income of the corporation.

Where, however, a corporation issues so-called "debenture bonds" secured by mortgages on real estate made

by borrowers from the corporation in favor of such corporation, the interest on such bonds is not deductible from the taxable income. In the case of *Middlesex Banking Company vs. Robert O. Eaton, Collector* (221 Fed., 86), affirmed by the United States Circuit Court of Appeals, it was found upon the trial that the plaintiff, under its charter had the powers of a safe-deposit company, of a bank of deposit, and of a company to sell securities, but that its principal business was the sale of securities. Judge Ward of the United States Circuit Court of Appeals found that "practically the whole of the business done by the plaintiff during the years in question was the sale of its own obligations, called 'debenture bonds,' secured by mortgages on property in the South and West, deposited with the Columbia Trust Co. as trustee for the bondholders, and of the obligations of borrowers to the plaintiff, secured by mortgages, which, accompanied by its own interest coupons for a less rate of interest than it receives from the borrowers, it guarantees as to both principal and interest and sells to purchasers. These latter are called 'guaranteed real estate securities.' Both these forms of securities the plaintiff sells throughout the East by means of agents, and its profit in each case is represented by the difference between the rate of interest it receives from its southern and western borrowers and the interest which it pays to the eastern purchasers of the obligations."

The plaintiff's theory was that the interest in question was paid upon money deposited with it and as such was deductible; this the Court disposed of in the following language: "Without stopping to analyze the charter powers of the plaintiff and to determine whether it is or is not a bank or banking association and, whether, if so, it has not also other and different powers, we think it perfectly clear that the interest in question is not interest upon money deposited with it, but is interest paid on its own obligations or on the obligations of others guar-

anted by it which it has sold to the investing public. The purchase price is no more money deposited with the plaintiff at interest than is money paid to a railroad company for the purchase of its bonds. The transaction is not a banking transaction at all like the giving of a pass book or a certificate of deposit to a depositor, but a business of selling securities to investors. *Selden vs. Equitable Trust Co.* (94 U. S., 419)."

F. A. Cleveland, in his work on "Funds and Their Uses," says that: "The term debenture bond is the most loosely used of any of the terms descriptive or suggestive of financial instruments." The test of deductibility of interest on such bonds is whether it is actually an "expense of the business," and to be such it must be paid upon an actual obligation of the company, not merely upon an "evidence of indebtedness." Interest paid as a distribution of profits is not deductible in an income tax return.

Dividends Received

Dividends received by a corporation should be credited to "Dividends Received Account" and in the income tax return included in item 3 (d) under "Gross Income." Dividends received out of earnings accrued prior to March 1, 1913, are not taxable to the recipient.

Stock dividends constitute taxable income to the amount of their cash value and "such cash value is held to be the proportionate share of the surplus accrued to the paying corporation since March 1, 1913, as is represented by the stock distributed or ordered to be distributed to the receiving corporation."

Inasmuch as corporations pay the normal tax (2%) on their net earnings, dividends paid to individual stockholders out of such net earnings are free from a further normal tax. But that is not so in the case of dividends paid to a corporation stockholder. Such corporate stockholder is again taxable on its net income, which includes the dividends received. Hence, on dividends paid by one

corporation to another corporation, the normal tax is paid twice.

It is not necessary that the dividends be actually paid either by cash or stock, because "dividends shall be held to mean any distribution made or ordered to be made by a corporation out of its earnings." Therefore, a mere credit on the books of the issuing corporation is sufficient to obligate the recipient to include the amount of such credit applicable to him or it (a corporation) as income in his or its return of net income.

**Income
Sundry
Sources**

All income, other than that derived from trading, rentals, interest, dividends received, and income from the sale of capital assets, should be credited in the ledger to an account "Income from Sundry Sources" and should be stated in item 3 (e) under "Gross Income." Profits from the sale of capital assets should be included in this item of the return. For treatment of the account in the ledger, and method of computing profit from the sale of capital assets, see page 105.

In the supplementary statement, item 3 (e), all income from sources other than those specifically called for in the return, which is subject to tax, should be itemized.

**Labor,
Wages and
Commissions**

These items are called for *in toto* in the supplementary statement of the report, item 4 (a) 1, under "Expenses, General." "Labor" and "wages" for the purpose of the income tax return, apply to all wages, direct and indirect (except where a cost-system is operated, see page 110). All salaries, other than those of officers of the corporation which are stated separately in item 4 (a) 6, should be included in "Labor, Wages and Commissions." Bonus and profit sharing payments to employees other than officers which are not gratuities, but additional pay for services actually rendered, should be included in this deduction. A separate ledger account should be kept to which items of this class will be charged.

Separate ledger accounts should be kept for wages and

commissions, respectively, and each of them should be further subdivided into separate accounts according to requirements of the business. For example, wages paid in connection with production (Productive Wages), office salaries, salaries of salesmen, etc., should be carried in separate accounts to facilitate the preparation of intelligible Profit and Loss Accounts and for purposes of comparison of various departmental expenses of different periods.

Commissions, also, should be kept in accounts, that, by their title, designate whether they are applicable to cost of production, administration or selling expenses.

Income from commissions should be credited to a "Commissions Received Account" and included in item 3 (e) under "Gross Income" of the tax return. Where commissions are both received and paid they should always be credited and charged, respectively, to separate ledger accounts that by their title are descriptive of their contents.

**Fuel, Light,
Power, etc.**

These items, called for in the supplementary statement, item 4 (a) 2, under "Expenses, General," should contain *in toto* only the cost of supplies and service purchased, such as coal, gas, electricity, power, etc., and should not include labor of engineers, firemen, etc., which latter are called for by item 4 (a) 1.

Ordinarily the items to be included in line 4 (a) 2 are charged in an account called "Light, Heat and Power." To make easier the preparation of the tax return such accounts should be subdivided, one for labor, and the other for supplies consumed in the production of light, heat and power, as "Light, Heat and Power, Labor" and "Light, Heat and Power, Supplies."

**Repairs,
Ordinary
and
Incidental**

For the purpose of the income tax return, it is necessary only to keep one general "Repair Account" of materials. For accounting purposes, however, repairs should be subdivided according to requirements, as Re-

pairs to Machinery and Plant, Repairs to Buildings, etc. To more easily prepare the tax report these accounts again should be divided into Repairs—Materials and Supplies, and Repairs—Wages, because they are called for separately. The separation of wages and materials only applies where the repairs are made by own employees of the corporation. Where the repairs are made by “outsiders” the total cost of repairs may be charged in item 4 (a) 4.

Care should be exercised to differentiate repairs and renewals from improvements and betterments; the latter are not deductible as expenses. A mere replacement that is not an improvement and does not enhance the material value is chargeable as a repair; the same is true of that which merely maintains efficiency.

Salaries of Officers

A separate ledger account, to which should be charged all salaries of officers, should be kept. The amount of such salaries will be stated in the supplementary statement of the return in item 4 (a) 6, under “Expenses, General.” A salary is, in the ordinary acceptance of the word, a compensation that is fixed by agreement in advance. Salaries, to be deductible, shall not be based upon stockholdings; they must be a business expense and not a distribution of profits. A distribution of profits is not deductible as an expense.

Where, however, “special payments, often designated as bonuses, are made to officers or employees of corporations, pursuant to a contract, express or implied, as additional compensation for services rendered, which payments, when added to the stipulated salaries, do not exceed a reasonable compensation for the services rendered, such payments may be regarded as a part of the wages or hire of the officer or employee, and, as such, may allowably be deducted from gross income as a business expense.” In such case the bonus or additional compensation of an officer should be included in item

4 (a) 6, "Salaries of Officers." But "this ruling contemplates that such payments are conditioned upon the services rendered by the employee and not upon the earnings of the corporation. If it should appear that the additional or special payments are dependent upon the earnings of the company, rather than upon the services rendered, or if such payments are made only occasionally, and then, at the option of the corporation, as a sort of thank-offering because of a prosperous year, and not in pursuance of a fixed policy or practice, or any contract, express or implied, it will be held that such payments are gratuities and, as such, are not properly deductible from gross income."

Voluntary contributions or donations, such as "Christmas gifts" are not deductible. But a payment by an employer to his employee, irrespective of when made, during the holiday or any other season of the year, in consideration of services rendered, as extra compensation, is deductible by the payer.

Sundry Expense Accounts

In addition to the accounts, the balances of which are separately called for by the return, every mercantile concern has more or less additional expenses for which separate accounts, according to requirements, should be kept, such as:

Freight on Sales	Insurance
Packing Supplies	Postage
Shipping Supplies	Stationery & Printing
Stable Expense	Telegraph & Telephone
Auto Expense	Legal Expense
Advertising	Auditing Expense
Traveling Expense	General Office Expense

In the case of a manufacturing company, that does not operate a cost-system as an integral part of the bookkeeping system (see page 110) an intelligible classification would require such additional accounts as General Factory Expense, Production Supplies, etc.

All expenses that are not separately provided for in the return, such as those just mentioned, should be stated in item 4 (a) 7 "Other Expenditures" in the supplementary statement. It is not necessary to state each account separately; they may be combined so as to include them all in five groups. Each group should contain items related to each other or coming under the same general head of production, administration or selling expenses. For example, they may be grouped as follows:

Packing and Shipping Supplies,
Stable and Auto Expense,
Advertising and Traveling Expense,
Postage, Stationery, Telegraph & Telephone,
Legal and Auditing Expense.

Items that cannot be classified under a general head may be stated as "Miscellaneous Unclassified Expenses," but the amount so stated should be comparatively small.

Customs Duties

Import duties and import taxes should be charged to "Duties Account" in the ledger and included in the return as expense in item 4 (a) under "Deductions" and in the supplementary statement in item 4 (a) 7. These items should not be deducted as taxes.

Salaries in Excess of \$3,000

Withholding Tax

The names of all officers and employees receiving salaries of \$3,000 or more per annum, shall be reported in the supplementary statement in item 4 (a) 8, under "Expenses, General." The total of this column does not enter into the main report because the salaries here reported are included under "Expenses, General" in item 4 (a) 1 and 4 (a) 6. Salaries paid by capital stock, rentals or by property shall be stated at the cash value thereof. Every corporation shall withhold for the year 1916 1 per cent. of the amount paid to officers and employees, and every year thereafter 2 per cent. on all salaries paid in excess of the amount of exemption to

which the recipient is entitled, namely, unmarried persons \$3,000, and married persons or head of family \$4,000.

A corporation shall not deduct such exemption unless the individual entitled thereto files with it a certificate of exemption in due time.

All individuals receiving income in excess of \$3,000 per annum must make and file return on Form 1040 in addition to the returns of their employers.

**Report of
Withholding
Corporation**

In addition to the return of annual net income (Form 1031) every corporation, paying salaries of \$3,000 or more in the year, must make a return on Form 1042 Revised (Tax Withheld at Source, etc.). This is compulsory, and failure to file such additional return in due time subjects the corporation to a fine of from \$20 to \$1,000. Under the old income tax law fines were imposed without exception for failure to file return of taxes withheld.

**Bad
Debts**

Uncollectible accounts receivable should be charged to a separate account that by its title designates what it contains, such as Bad Debts, Uncollectible Accounts or Bad Accounts. Bad debts should not be charged to Profit and Loss Account until at the end of the fiscal period, when the books are closed.

Rulings direct that accounts shall be deducted only when they have been actually ascertained to be worthless. Reserves to provide for anticipated bad debts are not deductible. The accounts deducted must be charged off in the books of account during the year for which the return is made, wherein the accounts are deducted.

Payments received on accounts after they have been charged off should be credited to Income from Bad Debts Account and stated in the return as income "From other sources" under "Gross Income." The total of such income should also be stated in the supplementary statement of the return in item 3 (e) designating the same as "Income from Bad Debts."

In the return of corporations it is not required to state of what the debts charged off consist, when they were created, when they became due, how they were actually ascertained to be worthless, etc., as is required of individuals. But the fact that this is not asked of them does not indicate that corporations are allowed any greater leeway than are individuals.

The most prevalent causes that justify the charging off of accounts receivable, are:

1. Bankruptcy of debtor,
2. Assignment by debtor for benefit of creditors,
3. Execution against property returned unsatisfied,
4. Disappearance of debtor leaving no assets,
5. Death of debtor leaving no estate.

The test of charging off accounts should not be limited to the reasons stated above. Each case should be determined upon the particular conditions governing it. The language of rulings under the old income tax law would indicate that legal procedure must be exhausted before an account may be charged off. That, no doubt, is true in many cases, but all accounts do not justify the expenditure of money to effect collection.

Bankruptcy, as a general rule, is sufficient in itself to warrant the charging off of an account. The average per cent. of dividends paid by the estates of bankrupts to creditors is so small that unless it is apparent that an estate has good assets, in a reasonable proportion to the liabilities, the entire account may be charged off at once. Where dividends are received thereon, such dividends should be stated as income.

The question as to when an account is "actually ascertained to be worthless" is one that can best be answered by the creditor, and he might better err on the side of safety than to permit the accumulation of uncollectible accounts.

**Loss by
Fire**

Fire losses usually involve both capital and current assets. It is customary immediately after a fire casualty to proceed to arrive at an inventory based on cost of the destroyed, partly destroyed and damaged merchandise for insurance purposes. When this has been done the value of the destroyed and damaged merchandise, based on such inventory, should be charged to an account in the ledger bearing title of "Fire Loss Account." To this account should also be charged all expenses incurred in the adjustment of loss, including compensation of adjusters, if any, as well as the cost of repairs and replacement of buildings occasioned by the fire. The amount recovered from insurance companies should be credited to said account. The debit excess of the Fire Loss Account will then represent the loss sustained by fire which should be included in the income tax return, item 5 (a) under "Deductions," and under the same designation in the supplementary statement. At the end of the fiscal period the balance of Fire Loss Account should be charged to Profit and Loss Account.

**Sales of
Capital
Assets**

The profit or loss on the sales of capital assets is determined in the case of assets acquired subsequent to March 1, 1913, by the difference between the cost and selling price. If the assets sold were acquired prior to March 1, 1913, then the profit or loss is the difference between the fair market value on March 1, 1913, and the selling price.

The profit or loss on the sale of capital assets should be credited or charged, respectively, to "Income on Sales of Capital Assets Account" and "Loss on Sales of Capital Assets." The debit of such accounts will be a transfer of the cost or fair market value, as the case may be, from the asset account in which the subject of sale had previously been carried in the ledger.

According to the supplementary statement of the income tax return, it would appear that the profit on sales

of capital assets should be included in "Gross Income From Operations." This is obviously wrong in principle, and it is suggested that such income be stated in item 3 (e) under "Gross Income" calling for income "From other sources." Losses on sales of capital assets should be included in item 5 (a) under "Deductions."

Depreciation

This subject has been treated at some length in Chapter IV, pages 68 to 85. Suffice it to say here, that any amount deducted in the return of net income for depreciation (item 5 (b) in both the report and supplementary statement) must be actually charged off in the ledger, either on the asset account itself or in a negative account, such as, a Reserve for Depreciation.

Depreciation is usually charged off by a journal entry, debiting Depreciation Account and crediting Reserve for Depreciation. The Depreciation Account is closed into the Profit and Loss Account and the Reserve Account remains open until the asset that it offsets (writes down), is either sold or otherwise disposed of; then the difference between the cost and the amount written off in past years, plus proceeds of sale, is charged off as a capital loss or profit, as the case may be.

Depletion

As in the case of depreciation of property, depletion of mines and oil or gas wells, by reason of exhaustion of the natural product, must be actually charged off in the ledger of the corporation seeking the deduction. Mere memorandum entries thereof are insufficient. The purpose of an allowance for depletion is to return to the corporation the capital invested, or, in case of purchase prior to March 1st, 1913, an amount sufficient to return to the corporation the fair market value of such deposits as at that date. Depletion should be entered in item 5 (c) of both the return proper and the supplementary statement.

**Ledger
Entry of
Depletion of
Property**

It has been indicated by the Commissioner of Internal Revenue that in order to render a claim for depletion of property deductible from income for tax purposes,

it is insufficient to make a mere journal entry thereof; it must be actually charged off in the general ledger, either against the asset account of the property depleted, or to the credit of "Reserve for Depletion"; further, that such reserve shall be deducted from the asset account in the balance sheet, as well as in the report to the stockholders. The amount deducted for depletion in an income tax return must, in fact, be charged off in such way that it reduces the asset account in the general ledger by the amount deducted in the return of annual net income.

Taxes

Taxes should be charged to an account in the ledger bearing that title. All taxes are deductible except that:

1. Foreign taxes accruing to a foreign corporation are not deductible from income derived upon capital invested in this country.
2. Taxes paid for local benefits are not deductible.
3. Taxes paid by corporations to render their stock or bonds tax-free are not deductible, because such taxes are primarily obligations of their stockholders and bondholders.

Foreign taxes paid by a corporation organized under the laws of any State of the United States are deductible, because such corporation pays an income tax on its entire net income irrespective of where such income is derived or where its capital is invested.

Treatment of Taxes Deducted at Source on Books of Recipient of Income

Journal entries of income tax items may be avoided by providing a separate column in the cash book for income tax deducted at the source. In the books of the recipient of income on which the tax has been withheld, the amount deducted becomes a charge to Tax Deducted at Source Account. Cash Account is debited with the net amount of cash received, the tax deducted is debited in the special column provided therefor, and the credit to the income account is stated at the gross amount, inclusive of both cash received and tax deducted. The

income tax deducted may then be posted in totals at the end of each month. Tax Deducted at Source Account becomes a prepaid expense until it has been deducted from the annual return of the recipient. This is applicable particularly to individuals, but will also apply to such foreign corporations as are subject to have the income tax withheld.

**Treatment
of Tax
Withheld at
Source on
Books of
Payer of
Income**

A separate column should also be provided in the cash book of the payer of income that is subject to withholding of tax at the source of payment. This applies to individuals and corporations generally. The net amount of cash paid (obligation, less tax withheld) is credited to Cash Account. The amount of tax withheld is entered in the special column and credited to Income Tax Withheld Account. The expense chargeable is debited with the total (cash paid plus tax withheld). Having a separate column in the cash book makes it possible to post the items withheld in totals at the end of each month, thereby reducing the number of individual postings. At the same time the Income Tax Withheld Account represents at all times the amount owing to the Government by reason of such deductions. When the tax is paid to the Collector such payment is charged to the Income Tax Withheld, which closes the account.

**Capital
Stock**

Item 1 of the income tax return calls for the amount of capital stock paid-in and outstanding. This does not include either stock unissued or "treasury stock." If the corporation has no capital stock, then it should state the amount of capital employed in the business, which, ordinarily, is the excess of the assets over liabilities, *i. e.*, invested capital plus surplus.

Item 1, in the supplementary statement, calls for the division of capital stock into common and preferred. If the company has no capital stock then the "capital employed in the business" should be stated. (See interpretation, page 95.)

**Interest-
bearing
Indebted-
ness**

Item 2, in the main report, calls for the amount of bonded and other interest-bearing indebtedness outstanding at the close of the year, exclusive of indebtedness wholly secured by collateral, the subject of sale or hypothecation in the ordinary business of the corporation.

Item 2, in the supplementary statement, calls for details by classification, rate of interest and amount of principal of all interest bearing indebtedness. It includes all the items of item 2 in the body of the report, and in addition thereto, the total amount owing, etc., on debts, wholly secured by collateral, the subject of sale in the ordinary business of the corporation.

**Merchandise
Account**

It will be noted that no provision has been made for a merchandise account; instead, separate accounts have been recommended, consisting of Sales, Purchases, Return Sales and Inventory. Return purchases, ordinarily, may be credited to Purchase Account. A Merchandise Account has no place in a modern set of books.

**Profit and
Loss Account**

No postings should be made to the Profit and Loss Account during the interim of a fiscal period, that is to say, until the books are closed at the end of the year.

The practice of charging or crediting expenses or losses and income, respectively, direct to Profit and Loss Account, makes it necessary to analyze the account in order to allocate the items contained therein for purposes of the tax return. But apart from this disadvantage and as a matter of good accounting, Profit and Loss Account should contain no entries until the close of the fiscal period. In the meantime all items of income and expense should be credited or charged to accounts that by their titles are descriptive of their contents.

After the books have been closed the balance of Profit and Loss Account should be transferred either to Surplus or Impairment of Capital Account, as the case may be.

Dividends Declared

Dividends declared should be charged to Surplus Account and credited to Dividend Account against which the payments of dividends should be charged.

Reconciliation of Return with Books of Account

For the purpose of future reference, the net income as shown by the return of net income should be reconciled with the result shown by Profit and Loss Account. The difference, where the return is made for the fiscal year of the corporation, will consist of such items of income as are not taxable, readjustment of book values to express appraisal valuations or expenses or losses not by law deductible.

Items are not deductible unless they are charged off in the books of account within the year covered by the return.

Manufacturing Corporations Operating Cost-System

"A manufacturing corporation may include as an element of the cost of manufactured products, the cost of raw material, the cost of labor of the men who actually work on such products, as well as the cost of supervisory, or what may be designated as 'unproductive labor,' such as that of the foremen, inspectors, overseers, etc., provided such expenditures are not separately deducted from gross income in the Return of Annual Net Income.

"The overhead charges referred to in Form 1031 should include the salaries of officers, clerk hire, and such other office expenses as do not have to do directly with the manufacture of the product." (T. D., 2152.)

This ruling under the old law, and provisions with respect to account keeping of the amended law, makes it possible for manufacturing corporations employing cost-systems, that are embraced in the general books of account and subject to proof as to accuracy, to make their returns on the basis of cost of production, as shown thereby. The form of the return (1031), however, is not well adapted to that kind of report. For example, it calls for items under "Deductions" that

ordinarily (according to opinion of the cost accountant) are charged to the cost of production, as rent, fuel, light and power, repairs, payments in lieu of rent, depreciation, depletion and taxes. Any of these items that are included in the cost of production through the cost-system, should not again be stated as deductions.

Items that have been included in the cost of production that are separately provided for in the report or supplementary statement thereof, should be explained by a notation "included in cost of manufacture." The detailed information as to basis of computing depreciation and depletion, and amount of domestic and foreign taxes charged to the period, should be furnished in the supplementary statement even though these items, or either of them, were included in the cost of manufactured goods.

Where interest on capital is theoretically added to the cost of production, such interest, for income tax purposes, must either be deducted from the cost of production or separately stated as income in the return.

It is quite usual to maintain, in connection with a modern cost-system, a "perpetual" or "running" inventory. Irrespective of the degree of care with which such inventory may be operated, more or less differences occur in the course of time. This necessitates the taking of physical inventories and the adjustment of the "running" inventory therewith. Physical inventories should be taken and the book inventory reconciled therewith at least once in each fiscal period.

CHAPTER VI

INFORMATION REQUIRED TO PREPARE RETURN OF NET INCOME OF MERCANTILE CORPORATION

The following is a list of all items required in order to prepare a return of net income of a mercantile corporation, showing where each item should be entered in the return proper, and in the supplementary statement thereof.

Where the books of account are kept upon the "accrual basis," the amount accrued or deferred may be included in the return but no accrued expense so deducted shall exceed:

1. The amount due and payable within the year, or
2. An amount actually accrued or incurred for which the business received value within the year.

Item.	Return.	Supplementary Statement.
1. Total capital stock issued and outstanding at close of year. In case of partly paid stock, then the amount of instalments paid in at the close of year.....	1	
2. Common stock, paid-up, at close of year.....		1
3. Preferred stock, paid-up, at close of year		1
4. If the stock has no par value, then the amount of capital employed in the business at the close of the year, exclusive of liabilities and borrowed capital.....	1	1

Item.	Return.	Supple- mentary Statement.
5. Total amount of interest-bearing indebtedness at close of year, exclusive of indebtedness wholly secured by collateral, the subject of sale in ordinary business of the corporation.....	2	
6. Character of obligation, rate of interest and amount of principal at close of year of all interest-bearing indebtedness, for the payment of which the corporation or its property is bound, including that wholly secured by collateral.....		2
7. Stock on hand at close of year. (At cost)		3 (a)
8. Stock on hand at beginning of year. (At cost)		3 (a)
INCOME.		
9. Sales of Merchandise, less discounts allowed, allowances on goods sold and return sales...		3 (a)
10. Rentals received, including royalties, if any.....	3 (b)	
11. Interest received on government bonds, or any other Government obligation, including municipal, state and Federal (not taxable)		3 (c)
12. All interest received, other than that on Government securities.	3 (c)	

Item.	Return.	Supple- mentary Statement.
13. Dividends received out of earnings of corporations and limited partnerships, accrued since March 1st, 1913.....	3 (d)	
14. Income received from all other sources. (Itemized)	3 (e)	3 (e)

DEDUCTIONS.

15. Purchases, plus transportation charges thereon, less return purchases, discounts and "anticipations" received		3 (a)
16. All labor, wages and commissions (not including salaries of officers)	4 (a)	4 (a) 1
17. Fuel, light, power, etc.....	4 (a)	4 (a) 2
18. Rentals paid during the year....	4 (a)	4 (a) 3
19. Repairs, ordinary and incidental. (Not including improvements and betterments)	4 (a)	4 (a) 4
20. Total of salaries paid to officers..	4 (a)	4 (a) 6
21. Bad debts (uncollectible accounts) actually ascertained to be uncollectible and charged off in the books of account within the year	5 (a)	5 (a)
22. Losses on capital assets computed on basis outlined on page 22..	5 (a)	5 (a)
23. All other losses not recovered by insurance or otherwise.....	5 (a)	5 (a)

Item.	Return.	Supple- mentary Statement.
24. Depreciation charged off on all depreciated properties, and the following data as to each class of property:		
(a) Kind of property.....		5 (b)
(b) Its cost		5 (b)
(c) Probable life after ac- quirement		5 (b)
(d) Amount charged for year covered by return	5 (b)	5 (b)
(e) Total amount charged off thereon in previous years		5 (b)
NOTE.—In case of buildings, state kind of construction—as frame, brick, concrete, etc.		
25. Interest paid during the year classified as follows:		
a. Interest paid on indebtedness wholly secured by collateral, the subject of sale or hypothecation in ordinary business of the corporation. (This item is deducted as a general expense)	4 (a)	4 (a) 5
b. Interest paid on mortgages secured by property which the corporation occupies but does not own. (To be included in item "Payments in lieu of rent")	4 (b)	
c. All other interest paid, including that on bonds, borrowed capital, bank loans and accounts bearing interest..	6 (a)	
NOTE.—The amount on which interest is deductible shall not exceed the paid-up		

Item.	Return.	Supple- mentary Statement.
capital stock outstanding at the close of the year, or if no capital stock the amount of capital employed in the business, plus one-half of the interest-bearing indebtedness then outstanding.		
26. Also the following data with respect to interest paid:		
(a) Name or kind of obligation. (Bonds payable, bills payable, accounts payable, loans payable, etc.)		6 (a)
(b) Amount of principal...		6 (a)
(c) Rate of interest.....		6 (a)
(d) Amount of interest paid.		6 (a)
NOTE.—The above detailed information should be given as to each class of interest-bearing indebtedness.		
27. Taxes paid or accrued on the books of account not in excess of the amount due and payable within the year:		
Domestic, Federal, State, etc. (Not including local benefits)	7 (a)	7 (a)
Foreign (of domestic corporations only)	7 (b)	7 (b)
28. All other expenditures or expenses not separately called for above, such as: Freight on Sales, Advertising, Traveling Expense, Insurance, Postage, Stationery, Telephone and Telegraph,		

Item.	Return.	Supple- mentary Statement.
Legal Expense, General Office Expense, etc., classified into five groups. (See page 101)...	4 (a)	4 (a) 7
29. Miscellaneous information as follows: Names and addresses of officers and employees receiving \$3,000 or more in the year and the amount thereof.....		4 (a) 8
30. Detailed information as to the sales of capital assets, including original cost of such assets, if acquired since March 1st, 1913; fair market value as of March 1st, 1913, if acquired prior to that date; how such "fair market value" was ascertained; selling price, and the resulting profit or loss, as the case may be:		
Profits	3 (e)	3 (a)
Losses	5 (a)	5 (a)
31. If the return is not made on the basis of actual receipts and disbursements, then state how the income was computed.....		7 (b)
The difference between items designated 3 (a) in the order stated in the supplementary statement, being the "Gross Income from Operations" should be entered in the return in item	3 (a)	

Item.	Return.	Supple- mentary Statement.
<p>Where the same designation appears more than one time under "Returns" the aggregate amount of all such items should be entered in the report proper. Items called for by the "supplementary statement" should be separately entered.</p>		

CHAPTER VII

PREPARATION OF INCOME TAX RETURNS OF
INDIVIDUALS**Method of
Bookkeeping**

The privilege afforded by the income tax law to corporations with respect to the preparation of income tax returns upon a basis other than that of actual receipts and disbursements is also extended to individuals, in the following language:

“An individual keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect his income, may, subject to regulations made by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, make his return upon the basis upon which his accounts are kept, in which case the tax shall be computed upon his income as so returned.”

The “accrual method,” if it may be so called, is explained on page 88.

**Separation
Income Tax
Withheld at
Source**

Columns “A” and “B” of the income tax return should, respectively, contain income on which the normal tax has been withheld at the source of payment and income on which the normal tax has not been withheld. In column “A” should be entered the gross amount of income on which the tax has been withheld, *i. e.*, inclusive of the amount of tax deducted by the withholder. For example, in the case of a salary of \$10,000, less the personal exemption of \$4,000, the tax withheld for the year 1916 would be 1 per cent. (after January 1, 1917, 2 per cent.) of \$6,000, namely, \$60, and the recipient of such salary would receive during the year \$9,940. But the amounts to be entered in the return are: \$6,000 in column “A” and \$4,000 in column “B.”

INCOME.

Separate or
Combined
Returns of
Husband and
Wife

Husband and wife may render separate returns or either of them may make the return and include the income and deductions of the other as provided by the form of the return. If separate returns are made by husband and wife, each of them shall only deduct, respectively, his and her own expenses and deductions. In any case the aggregate personal exemption deducted by both husband and wife, shall not exceed \$4,000.

Return of
Merchant

Individuals engaged in mercantile or manufacturing business on their own account, and unincorporated, are not called upon to state in their returns the same amount of detail that is required of corporations. The gross profit from operation of a business will be entered in item 16 under "Gross Income" on page 2 of the return. The following illustrates method of computing gross profit:

Net Sales for the year.....	\$50,000 00
Stock on Hand (beginning of year)	\$7,500 00
Add Purchases during the year....	35,000 00
<hr/>	
Total	\$42,500 00
Deduct Stock on Hand (end of year)	6,500 00
<hr/>	
Cost of Goods Sold.....	36,000 00
<hr/>	
Gross Profit for the Year (Entered in Item 16).	\$14,000 00

All expenses of the business, other than interest, taxes, losses arising from fires, storms, or other casualties and from theft, not compensated for by insurance, bad debts and depreciation, will be entered in item 32 on page 3 under "General Deductions."

As to what comprises "Net Sales" and "Purchases," see pages 89 and 90, respectively.

Interest
Received

All interest received by an individual, excepting that on bonds or other obligations of the Government (tax exempt) is returnable for income tax purposes and

should be separated into the three classes prescribed by the return and entered in the respective items, as follows:

Interest on promissory notes of individuals and corporations, mortgages of individuals, bank deposits, loans, and from other sources not included in the following classifications, to be entered in item 18 under "Gross Income."

Interest upon obligations of domestic corporations, joint-stock companies or associations and insurance companies, including bonds, mortgages, deeds of trust, or other similar instruments, to be entered in item 19 under "Gross Income."

Interest upon obligations of foreign corporations engaged in business in foreign countries, such as bonds, mortgages, deeds of trust or other similar obligations, issued in foreign countries; also, dividends received upon the stock of such foreign corporations, to be entered in item 22 under "Gross Income."

**Salaries,
Wages and
Commissions**

Under the present income tax law it is not required that an individual shall report income from any source until the same is actually received. A promissory note, for income tax purposes, has been ruled to be payment and should be treated as a cash receipt. Upon default of payment thereof such note may be deducted when it has been ascertained to be worthless.

Income received in property, *i. e.*, the equivalent of cash, should be reported at the cash value thereof.

Salaries, wages and commissions from all sources should be entered in item 14 under "Gross Income."

All commissions and other compensation received by persons acting in a fiduciary capacity, should be reported in this item. In cases where the administration of an estate covers a period of years, it is suggested that the compensation of the trustee be computed and reported, whether paid or not, for each year, because it has been ruled that where such compensation covering a period of years is paid in one sum, such compensation cannot be prorated over the period of years covered thereby.

**Professions
and Vocations**

The remarks stated above with respect to requirements of reporting income from salaries, wages and commissions, only when actually received, is also true of income from professions and vocations. A lawyer or doctor, for example, is not required to report income until actual payment of a fee has been received.

All income from professional or vocational sources should be entered in item 15 under "Gross Income."

**Business
Trade
Commerce**

In addition to gross income from mercantile and manufacturing pursuits, there should be included in item 16, under "Gross Income" all profits from the sale of real and personal property, including that derived from sources "not in trade," such as, profits on speculations. For method of determining profit on sales of properties purchased or acquired by the taxpayer prior to March 1, 1913, see page 23.

Rents

Rentals are not required to be reported until actually received by cash or the equivalent. The total of income from this source should be entered in item 17 under "Gross Income."

**Income from
Fiduciaries**

All income received from guardians, trustees, executors, administrators, receivers and conservators, or other persons acting in a fiduciary capacity, should be included in item 20 under "Gross Income." Dividends received from domestic corporations, through fiduciaries, however, which are not subject to the normal tax, should be entered in item 29.

**Partnership
Profits**

The share of profit and gains of partners in a partnership, whether distributed or not, should be reported in item 21, under "Gross Income," exclusive of dividends from domestic corporations which are returnable on line 28, "Dividends received through partnership."

Inasmuch as income of partnerships is not subject to withholding at the source the entire share in partnership

profits credited to the partner should be reported in column "B."

In cases where the partners by provision of partnership articles are allowed a drawing account in the form of salary, charged in the books of the partnership as an expense of the business, such salary compensation should be reported in item 14 of the return under "Gross Income" and the normal tax should be withheld thereon and paid by the partnership on amounts in excess of personal exemption.

Where the partners draw moneys on account of accruing profits, such withdrawals, being included in the partnership profits (distributed and undistributed) should not again be included in the return of net income.

**Royalties
Received**

All income received in the form of royalties from mines, oil wells, patents, franchises or other legalized privileges should be reported in item 23, under "Gross Income."

**Income from
Sundry
Sources**

All income not separately provided for in the return should be entered in item 24 and the source of each noted therein. It is not necessary to particularize the source except by general classification.

**Dividends
Received**

Dividends on stock of domestic corporations, which are subject to the normal tax on their income, should be reported on line 27 under "Gross Income." There should be included in this item all distributions of net earnings of such corporations, whether or not there was a formal declaration of dividends by the board of directors; for example, distribution of earnings by "close corporations" that do not observe technical requirements of corporation law with respect to the declaration of dividends by board of directors, but distribute profits informally as they accrue, should be included therein.

DEDUCTIONS.

Necessary Expenses

Unless the “accrual method” of account keeping is employed by the taxpayer, the amount deducted in item 32 under “General Deductions” should be only the total of expenses actually paid within the year. There shall not be included therein any personal, living or family expenses. In the case of a merchant this item will include the administration and selling expenses of his business but not the cost of merchandise purchases, which are deductible from sales in the ascertainment of gross profit entered in item 16 under “Gross Income.”

No partnership expenses are deductible in the return of an individual.

In the case of rented property, amounts expended for maintenance and repairs are deductible in this item, but amounts expended for permanent improvements or betterments are not competent deductions.

Interest Paid

All interest paid within the year by the taxpayer on his indebtedness is deductible in item 33 under “General Deductions.” There is no limitation as to the amount of interest deductible by an individual taxpayer, such as there is in the case of a corporation except, in the case of nonresident alien individuals, see page 30.

Taxes Paid

All national, foreign, State, county, school and municipal taxes paid within the year, not including assessments for local benefits, such as sewerage, sidewalk, street improvements, etc., are deductible in item 34 under “General Deductions.” Taxes paid on the residence of the taxpayer are deductible.

Losses In Trade

All losses sustained during the year incurred in business or trade, or arising from fires, storms, shipwreck or other casualties, and from theft, not compensated by insurance, or otherwise, are deductible in item 35 under “General Deductions.”

Where a loss is sustained in the sale of property acquired prior to March 1, 1913, the measure of loss is the difference between the fair market price or value as at March 1, 1913, and the amount realized from such sale.

This item should be supplemented with the following information:

- (a) Of what the loss consisted.
- (b) When it was actually sustained.
- (c) How it was determined to be a loss.
- (d) If sustained by sale of property acquired before March 1, 1913, the fair market price or value as of that date and how such value was determined.

**Loss Not
In Trade**

Losses sustained during the year in transactions entered into for profit but not connected with the business or trade of the taxpayer, should be entered in item 36 under "General Deductions." Such losses are only deductible up to the amount of profit or income during the year derived from the same class of transactions, which would be included under "Gross Income" in item 16.

The amount of profit or income derived from such transactions during the year should be entered under Item 36 and the same information called for with respect to losses incurred in trade in item 35 should be furnished with regard to losses not in trade.

Bad Debts

Uncollectible accounts actually ascertained to be worthless, charged off on the books of account of the individual within the year, should be stated in item 37, supplemented by the following information:

- (a) Of what the debts consisted.
- (b) When they were created.
- (c) When they became due.
- (d) How they were actually determined to be worthless.
- (e) Whether or not they have been included in the present or previous return.

As to what constitutes worthless accounts receivable for purposes of the income tax return, see page 103.

To render an item deductible under this title it must be actually charged off within the year.

Depreciation

A reasonable allowance for exhaustion, wear and tear of property, arising out of its use or employment in business or trade, should be deducted in item 38 under "General Deductions."

As to deductibility of depreciation on various classes of properties, see Chapter IV, on Depreciation, page 68. The following information should be given with respect to each class of property on which such deduction is made:

- (a) Kind of property on which depreciation is taken.
- (b) Cost of same.
- (c) What percentage of depreciation is claimed.

In case of buildings, state when erected and of what materials constructed.

Depletion

A reasonable allowance for depletion of oil, gas wells and mines should be deducted in item 39 under "General Deductions."

For limitation of deductibility of depletion on oil, gas wells and mines, respectively, see pages 27 and 28. In the case of property acquired prior to March 1, 1913, the depletion allowable shall be at a rate, which, during the estimated life of the property being depleted will return:

The cost of the property, if acquired after March 1, 1913, or
The fair market value as of March 1, 1913, if acquired before
that date.

These items should be supplemented with the following information:

- (a) The cost of property, if purchased after March 1, 1913.
- (b) The fair market value as of March 1, 1913, if purchased prior to that date.
- (c) How such value was determined.
- (d) The basis upon which the amount of depletion claimed was computed.

Illustration—
Method of
Computing
Normal and
Additional
Tax

For the purpose of illustrating the method of computing the normal and additional tax of an individual, based on requirements of the law for the year 1916 (only 1 per cent. withheld), the following summary of income and deductions is assumed:

Line of Re- turn.	Description of Income. (Page 2).	A.	B.
		Income on Which Tax Has Been Paid or Withheld.	Income on Which Tax Has Not Been Paid or Withheld.
25.	Totals (Note.—Enter 1 per cent of total amount of Column A on line 9)	\$80,000 00	\$250,000 00
26.	Aggregate Totals of Columns A and B.....		330,000 00
27.	Dividends on stock of corporations, etc., subject to like tax.....	\$5,000 00	
28.	Dividends received through partnership. (See line 21).....	500 00	
29.	Dividends received through fiduciaries. (See line 20).....	1,000 00	
30.	Total Dividends. (Lines 27, 28 and 29.) (Enter on line 4).....		6,500 00
31.	Total Gross Income (to be entered on line 1)		\$336,500 00
	Deductions (Page 3).		
40.	Total "General Deductions" (to be entered on line 2).....		\$25,000 00
Summary (Page 1).			
1.	Gross Income (brought from line 31).....		\$336,500 00
2.	General Deductions (brought from line 40).....		25,000 00
3.	Net Income		\$311,500 00
4.	Dividends brought from line 30....	\$6,500 00	
5.	Personal exemption (single, \$3,000; married or head of family, \$4,000)	4,000 00	
6.	Total dividends and personal exemption (Items 4 and 5).....		\$10,500 00

7. Amount of Income subject to normal tax.....	301,000 00
8. Amount of Normal Tax at rate of 2 per cent. on income shown on line 7.....	6,020 00
9. Credit by amount of normal tax paid or to be paid at source (1 per cent. of amount of in- come shown on line 25, Column A).....	800 00
10. Balance of normal tax due.....	\$5,220 00

	Income.	Tax.
One per cent. on amount over \$20,000 and not exceeding \$40,000.....	\$20,000 00	\$200 00
Two per cent. on amount over \$40,000 and not exceeding \$60,000.....	20,000 00	400 00
Three per cent. on amount over \$60,000 and not exceeding \$80,000.....	20,000 00	600 00
Four per cent. on amount over \$80,000 and not exceeding \$100,000.....	20,000 00	800 00
Five per cent. on amount over \$100,000 and not exceeding \$150,000.....	50,000 00	2,500 00
Six per cent. on amount over \$150,000 and not exceeding \$200,000.....	50,000 00	3,000 00
Seven per cent. on amount over \$200,000 and not exceeding \$250,000.....	50,000 00	3,500 00
Eight per cent. on amount over \$250,000 and not exceeding \$300,000.....	50,000 00	4,000 00
Nine per cent. on amount over \$300,000 and not exceeding \$500,000.....	11,500 00	1,035 00
Ten per cent. on amount over \$500,000 and not exceeding \$1,000,000.....
Eleven per cent. on amount over \$1,000,000 and not exceeding \$1,500,000
Twelve per cent. on amount over \$1,500,000 and not exceeding \$2,000,000
Thirteen per cent. on amount over \$2,000,000
11. Total additional tax.....		\$16,035 00
12. Balance of normal tax due, as shown on line 10		5,220 00
13. Total Tax Due.....		\$21,255 00

APPENDIX A

FEDERAL INCOME TAX LAW

ENACTED SEPTEMBER 8, 1916

PART I.—ON INDIVIDUALS

Normal Tax

SEC. 1. (a) That there shall be levied, assessed, collected, and paid annually upon the entire net income received in the preceding calendar year from all sources by every individual, a citizen or resident of the United States, a tax of two per centum upon such income; and a like tax shall be levied, assessed, collected, and paid annually upon the entire net income received in the preceding calendar year from all sources within the United States by every individual, a non-resident alien, including interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise.

Additional Tax

(b) In addition to the income tax imposed by subdivision (a) of this section (herein referred to as the normal tax) there shall be levied, assessed, collected, and paid upon the total net income of every individual, or, in the case of a non-resident alien, the total net income received from all sources within the United States, an additional income tax (herein referred to as the additional tax) of one per centum per annum upon the payment by which such total net income exceeds \$20,000 and does not exceed \$40,000, two per centum per annum upon the amount by which such total net income exceeds \$40,000 and does not exceed \$60,000, three per centum per annum upon the amount by which such total net income exceeds \$60,000 and does not exceed \$80,000, four per centum per annum upon the amount by which such total net income exceeds \$80,000 and does not exceed \$100,000, five per centum per annum upon the amount by which such total net income exceeds \$100,000 and does not exceed \$150,000, six per centum per annum upon the amount by which such total net income exceeds \$150,000 and does not exceed \$200,000, seven per centum per annum upon the amount by which such total net income exceeds \$200,000 and does not exceed \$250,000, eight per centum per annum upon the amount by which such total net income exceeds \$250,000 and does not exceed \$300,000, nine per centum per annum upon the amount by which such total net income exceeds \$300,000 and does not exceed \$500,000 ten per centum per annum upon the amount by which such total net income exceeds

\$500,000, and does not exceed \$1,000,000, eleven per centum per annum upon the amount by which such total net income exceeds \$1,000,000 and does not exceed \$1,500,000, twelve per centum per annum upon the amount by which such total net income exceeds \$1,500,000 and does not exceed \$2,000,000, and thirteen per centum per annum upon the amount by which such total net income exceeds \$2,000,000.

**Dividends
Subject to
Additional
Tax**

For the purpose of the additional tax there shall be included as income the income derived from dividends on the capital stock or from the net earnings of any corporation, joint-stock company or association, or insurance company, except that in the case of non-resident aliens such income derived from sources without the United States shall not be included.

All the provisions of this title relating to the normal tax on individuals, so far as they are applicable and are not inconsistent with this subdivision and section three, shall apply to the imposition, levy, assessment, and collection of the additional tax imposed under this subdivision.

**Calendar
Year**

(c) The foregoing normal and additional tax rates shall apply to the entire net income, except as hereinafter provided, received by every taxable person in the calendar year nineteen hundred and sixteen and in each calendar year thereafter.

INCOME DEFINED.

**Net Income
Defined**

SEC. 2. (a) That, subject only to such exemptions and deductions as are hereinafter allowed, the net income of a taxable person shall include gains, profits, and income derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form paid, or from professions, vocations, businesses, trade, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in real or personal property, also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever: *Provided*, That the term "dividends" as used in this title shall be held to mean any distribution made or ordered to be made by a corporation, joint-stock company, association, or insurance company, out of its earnings or profits accrued since March first, nineteen hundred and thirteen, and payable to its shareholders, whether in cash or in stock of the corporation, joint-stock company, association, or insurance company, which stock

**"Dividends"
Distributed
or Ordered
Distributed**

dividend shall be considered income, to the amount of its cash value.

Income of Estates

(b) Income received by estates of deceased persons during the period of administration or settlement of the estate, shall be subject to the normal and additional tax and taxed to their estates, and also such income of estates or any kind of property held in trust, including such income accumulated in trust for the benefit of unborn or unascertained persons, or persons with contingent interests, and income held for future distribution under the terms of the will or trust shall be likewise taxed, the tax in each instance, except when the income is returned for the purpose of the tax by the beneficiary, to be assessed to the executor, administrator, or trustee, as the case may be: *Provided*, That where the income is to be distributed annually or regularly between existing heirs or legatees, or beneficiaries the rate of tax and method of computing the same shall be based in each case upon the amount of the individual share to be distributed.

Individual Share of Beneficiaries

Indemnity to Fiduciaries

Such trustees, executors, administrators, and other fiduciaries are hereby indemnified against the claims or demands of every beneficiary for all payments of taxes which they shall be required to make under the provisions of this title, and they shall have credit for the amount of such payments against the beneficiary or principal in any accounting which they make as such trustees or other fiduciaries.

Basis of Determining Gain on Property Acquired Prior to March 1, 1913

(c) For the purpose of ascertaining the gain derived from the sale or other disposition of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such gain derived.

ADDITIONAL TAX INCLUDES UNDISTRIBUTED PROFITS.

Undistributed Profits Subject to Additional Tax

SEC. 3. For the purpose of the additional tax, the taxable income of any individual shall include the share to which he would be entitled of the gains and profits, if divided or distributed, whether divided or distributed or not, of all corporations, joint-stock companies or associations, or insurance companies, however created or organized, formed or fraudulently availed of for the purpose of preventing the imposition of such tax through the medium of permitting such gains and profits to accumulate instead of being divided or distributed;

**Unreasonable
Accumulation
Evidence of
Fraud**

and the fact that any such corporation, joint-stock company or association, or insurance company, is a mere holding company, or that the gains and profits are permitted to accumulate beyond the reasonable needs of the business, shall be prima facie evidence of a fraudulent purpose to escape such tax; but the fact that the gains and profits are in any case permitted to accumulate and become surplus shall not be construed as evidence of a purpose to escape the said tax in such case unless the Secretary of the Treasury shall certify that in his opinion such accumulation is unreasonable for the purposes of the business. When requested by the Commissioner of Internal Revenue, or any district collector of internal revenue, such corporation, joint-stock company or association, or insurance company shall forward to him a correct statement of such gains and profits and the names and addresses of the individuals or shareholders who would be entitled to the same if divided or distributed.

INCOME EXEMPT FROM LAW.

**Tax Exempt
Income**

SEC. 4. The following income shall be exempt from the provisions of this title:

Insurance

The proceeds of life insurance policies paid to individual beneficiaries upon the death of the insured; the amount received by the insured, as a return of premium or premiums paid by him under life insurance, endowment, or annuity contracts, either during the term or at the maturity of the term mentioned in the contract or upon the surrender of the contract;

**Gifts
Bequests**

the value of property acquired by gift, bequest, devise, or descent (but the income from such property shall be included as income); interest upon the obligations of a State or any political subdivision thereof or upon the obligations of the United States or its possessions or securities issued under the provisions of the Federal farm loan Act of July seventeenth,

**Interest on
Obligations
of State**

nineteen hundred and sixteen; the compensation of the present President of the United States during the term for which he has been elected, and the judges of the Supreme and inferior courts of the United States now in office, and the compensation of all officers and employees of a State, or any political subdivision thereof, except when such compensation is paid by the United States Government.

**Compensation
of Certain
Employees
of State**

DEDUCTIONS ALLOWED.

Deductions

SEC. 5. That in computing net income in the case of a citizen or resident of the United States—

(a) For the purpose of the tax there shall be allowed as deductions—

- Necessary Expenses** First. The necessary expenses actually paid in carrying on any business or trade, not including personal, living, or family expenses;
- Interest** Second. All interest paid within the year on his indebtedness;
- Taxes** Third. Taxes paid within the year imposed by the authority of the United States or its Territories, or possessions, or any foreign country, or under the authority of any State, county, school district, or municipality, or other taxing subdivision of any State, not including those assessed against local benefits;
- Losses in Trade** Fourth. Losses actually sustained during the year, incurred in his business or trade, or arising from fires, storms, shipwreck, or other casualty, and from theft, when such losses are not compensated for by insurance or otherwise: *Provided*, That for the purpose of ascertaining the loss sustained from the sale or other disposition of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such loss sustained;
- Loss on Property Acquired Prior to March 1, 1913**
- Losses not in Trade** Fifth. In transactions entered into for profit but not connected with his business or trade, the losses actually sustained therein during the year to an amount not exceeding the profits arising therefrom;
- Bad Debts** Sixth. Debts due to the taxpayer actually ascertained to be worthless and charged off within the year;
- Depreciation** Seventh. A reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business or trade;
- Depletion** Eighth. (a) In the case of oil and gas wells a reasonable allowance for actual reduction in flow and production to be ascertained not by the flush flow, but by the settled production or regular flow; (b) in the case of mines a reasonable allowance for depletion thereof not to exceed the market value in the mine of the product thereof, which has been mined and sold during the year for which the return and computation are made, such reasonable allowance to be made in the case of both (a) and (b) under rules and regulations to be prescribed by the Secretary of the Treasury: *Provided*, That when the allowances authorized in (a) and (b) shall equal the capital originally invested, or in case of purchase made prior to March first,
- Limitation of Depletion**

**Improvements
not
Deductible**

nineteen hundred and thirteen, the fair market value as of that date, no further allowance shall be made. No deduction shall be allowed for any amount paid out for new buildings, permanent improvements, or betterments, made to increase the value of any property or estate, and no deduction shall be made for any amount of expense of restoring property or making good the exhaustion thereof for which an allowance is or has been made.

CREDITS ALLOWED.**Normal Tax
Credits**

(b) For the purpose of the normal tax only, the income embraced in a personal return shall be credited with the amount received as dividends upon the stock or from the net earnings of any corporation, joint-stock company or association, trustee, or insurance company, which is taxable upon its net income as hereinafter provided;

Dividends

(c) A like credit shall be allowed as to the amount of income, the normal tax upon which has been paid or withheld for payment at the source of the income under the provisions of this title.

NONRESIDENT ALIENS.**Deductions
Nonresident
Aliens**

SEC. 6. That in computing net income in the case of a non-resident alien—

(a) For the purpose of the tax there shall be allowed as deductions—

**Necessary
Expenses**

First. The necessary expenses actually paid in carrying on any business or trade conducted by him within the United States, not including personal, living, or family expenses;

**Proportion
of Interest**

Second. The proportion of all interest paid within the year by such person on his indebtedness which the gross amount of his income for the year derived from sources within the United States bears to the gross amount of his income for the year derived from all sources within and without the United States, but this deduction shall be allowed only if such person includes in the return required by section eight all the information necessary for its calculation;

Taxes

Third. Taxes paid within the year imposed by the authority of the United States, or its Territories, or possessions, or under the authority of any State, county, school district, or municipality, or other taxing subdivision of any State, paid within the United States, not including those assessed against local benefits;

- Losses** Fourth. Losses actually sustained during the year, incurred in business or trade conducted by him within the United States, and losses of property within the United States arising from fires, storm, shipwreck, or other casualty, and from theft, when such losses are not compensated for by insurance or otherwise: *Provided*, That for the purpose of ascertaining the amount of such loss or losses sustained in trade, or speculative transactions not in trade, from the same or any kind of property acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such loss or losses sustained;
- Ascertaining Amount of Loss**
- Losses not in Trade** Fifth. In transactions entered into for profit but not connected with his business or trade, the losses actually sustained therein during the year to an amount not exceeding the profits arising therefrom in the United States;
- Bad Debts** Sixth. Debts arising in the course of business or trade conducted by him within the United States due to the taxpayer actually ascertained to be worthless and charged off within the year;
- Depreciation** Seventh. A reasonable allowance for the exhaustion, wear and tear of property within the United States arising out of its use or employment in the business or trade; (a) in the case of oil and gas wells a reasonable allowance for actual reduction in flow and production to be ascertained not by the flush flow, but by the settled production or regular flow; (b) in the case of mines a reasonable allowance for depletion thereof not to exceed the market value in the mine of the product thereof, which has been mined and sold during the year for which the return and computation are made, such reasonable allowance to be made in the case of both (a) and (b) under rules and regulations to be prescribed by the Secretary of the Treasury: *Provided*, That when the allowance authorized in (a) and (b) shall equal the capital originally invested, or in case of purchase made prior to March first, nineteen hundred and thirteen, the fair market value as of that date, no further allowance shall be made. No deduction shall be allowed for any amount paid out for new buildings, permanent improvements, or betterments, made to increase the value of any property or estate, and no deduction shall be made for any amount of expense of restoring property or making good the exhaustion thereof for which an allowance is or has been made.
- Limitation of Depletion**
- Improvements not Deductible**

(b) There shall also be allowed the credits specified by subdivisions (b) and (c) of section five.

PERSONAL EXEMPTION.

Individual
Exemption

SEC. 7. (a) That for the purpose of the normal tax only, there shall be allowed as an exemption in the nature of a deduction from the amount of the net income of each of said persons, ascertained as provided herein, the sum of \$3,000, plus \$1,000 additional if the person making the return be a head of a family or a married man with a wife living with him, or plus the sum of \$1,000 additional if the person making the return be a married woman with a husband living with her; but in no event shall this additional exemption of \$1,000 be deducted by both a husband and a wife: *Provided*, That only one deduction of \$4,000 shall be made from the aggregate income of both husband and wife when living together: *Provided further*, That guardians or trustees shall be allowed to make this personal exemption as to income derived from the property of which such guardian or trustee has charge in favor of each ward or *cestui que* trust: *Provided further*, That in no event shall a ward or *cestui que* trust be allowed a greater personal exemption than \$3,000, or, if married, \$4,000, as provided in this paragraph, from the amount of net income received from all sources. There shall also be allowed an exemption from the amount of the net income of estates of deceased persons during the period of administration or settlement, and of trust or other estates the income of which is not distributed annually or regularly under the provisions of paragraph (b), section two, the sum of \$3,000, including such deductions as are allowed under section five.

Ward
Cestui que
Trust

Estates

Exemption to
Nonresident
Alien
Conditional

(b) A nonresident alien individual may receive the benefit of the exemption provided for in this section only by filing or causing to be filed with the collector of internal revenue a true and accurate return of his total income, received from all sources, corporate or otherwise, in the United States, in the manner prescribed by this title; and in case of his failure to file such return the collector shall collect the tax on such income, and all property belonging to such nonresident alien individual shall be liable to distraint for the tax.

RETURNS.

Returns of
Net Income

SEC. 8. (a) The tax shall be computed upon the net income, as thus ascertained, of each person subject thereto, received in each preceding calendar year ending December thirty-first.

**When and
With Whom
to File Return**

(b) On or before the first day of March, nineteen hundred and seventeen, and the first day of March in each year thereafter, a true and accurate return under oath shall be made by each person of lawful age, except as hereinafter provided, having a net income of \$3,000 or over for the taxable year to the collector of internal revenue for the district in which such person has his legal residence or principal place of business, or if there be no legal residence or place of business in the United States, then with the collector of internal revenue at Baltimore, Maryland, in such form as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe, setting forth specifically the gross amount of income from all separate sources, and from the total thereof deducting the aggregate items of allowances herein authorized; *Provided*, That the Commissioner of Internal Revenue shall have authority to grant a reasonable extension of time, in meritorious cases, for filing returns of income by persons residing or traveling abroad who are required to make and file returns of income and who are unable to file said returns on or before March first of each year: *Provided further*, That the aforesaid return may be made by an agent when by reason of illness, absence, or nonresidence the person liable for said return is unable to make and render the same, the agent assuming the responsibility of making the return and incurring penalties provided for erroneous, false, or fraudulent return.

**Extension of
Time to File
Return****Return by
Agent****Returns by
Fiduciaries**

(c) Guardians, trustees, executors, administrators, receivers, conservators, and all persons, corporations, or associations acting in any fiduciary capacity, shall make and render a return of the income of the person, trust, or estate for whom or which they act, and be subject to all the provisions of this title which apply to individuals. Such fiduciary shall make oath that he has sufficient knowledge of the affairs of such person, trust, or estate to enable him to make such return and that the same is, to the best of his knowledge and belief, true and correct, and be subject to all the provisions of this title which apply to individuals: *Provided*, That a return made by one of two or more joint fiduciaries filed in the district where such fiduciary resides, under such regulations as the Secretary of the Treasury may prescribe, shall be a sufficient compliance with the requirements of this paragraph.

**Withholding
Tax at Source**

(d) All persons, firms, companies, copartnerships, corporations, joint-stock companies, or associations, and insurance companies, except as hereinafter provided, in whatever capacity

acting, having the control, receipt, disposal, or payment of fixed or determinable annual or periodical gains, profits, and income of another individual subject to tax, shall in behalf of such person deduct and withhold from the payment an amount equivalent to the normal tax upon the same and make and render a return, as aforesaid, but separate and distinct, of the portion of the income of each person from which the normal tax has been thus withheld, and containing also the name and address of such person or stating that the name and address or the address, as the case may be, are unknown: *Provided*, That the provision requiring the normal tax of individuals to be deducted and withheld at the source of the income shall not be construed to require the withholding of such tax according to the two per centum normal tax rate herein prescribed until on and after January first, nineteen hundred and seventeen, and the law existing at the time of the passage of this Act shall govern the amount withheld or to be withheld at the source until January first, nineteen hundred and seventeen.

That in either case mentioned in subdivisions (c) and (d) of this section no return of income not exceeding \$3,000 shall be required, except as in this title provided.

Partnerships

(e) Persons carrying on business in partnership shall be liable for income tax only in their individual capacity, and the share of the profits of the partnership to which any taxable partner would be entitled if the same were divided, whether divided or otherwise, shall be returned for taxation and the tax paid under the provisions of this title: *Provided*, That from the net distributive interests on which the individual members shall be liable for tax, normal and additional, there shall be excluded their proportionate shares received from interest on the obligations of a State or any political or taxing subdivision thereof, and upon the obligations of the United States and its possessions, and all taxes paid to the United States or to any possession thereof, or to any State, county, or taxing subdivision of a State, and that for the purpose of computing the normal tax there shall be allowed a credit, as provided by section five, subdivision (b), for their proportionate share of the profits derived from dividends. And such partnership, when requested by the Commissioner of Internal Revenue, or any district collector, shall render a correct return of the earnings, profits, and income of the partnership, except income exempt under section four of this Act, setting forth the item of the gross income and the deductions and credits allowed by this title, and the names and

Interest on
State
Obligations
Excluded

Dividends
Excluded

addresses of the individuals who would be entitled to the net earnings, profits, and income, if distributed.

**Dividends
Returnable**

(f) In every return shall be included the income derived from dividends on the capital stock or from the net earnings of any corporation, joint-stock company or association, or insurance company, except that in the case of nonresident aliens such income derived from sources without the United States shall not be included.

**Basis of
Keeping
Accounts**

(g) An individual keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect his income, may, subject to regulations made by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, make his return upon the basis upon which his accounts are kept, in which case the tax shall be computed upon his income as so returned.

ASSESSMENT AND ADMINISTRATION.

**When Tax
is Payable**

SEC. 9. (a) That all assessments shall be made by the Commissioner of Internal Revenue and all persons shall be notified of the amount for which they are respectively liable on or before the first day of June of each successive year, and said amounts shall be paid on or before the fifteenth day of June, except in cases of refusal or neglect to make such return and in cases of erroneous, false, or fraudulent returns, in which cases the Commissioner of Internal Revenue shall, upon the discovery thereof, at any time within three years after said return is due, or has been made, make a return upon information obtained as provided for in this title or by existing law, or require the necessary corrections to be made, and the assessment made by the Commissioner of Internal Revenue thereon shall be paid by such person or persons immediately upon notification of the amount of such assessment; and to any sum or sums due and unpaid after the fifteenth day of June in any year, and for ten days after notice and demand thereof by the collector, there shall be added the sum of five per centum on the amount of tax unpaid, and interest at the rate of one per centum per month upon said tax from the time the same became due, except from the estates of insane, deceased, or insolvent persons.

**Penalty
Delayed
Payments**

**Withholding
and Paying
Tax at
Source**

(b) All persons, firms, copartnerships, companies, corporations, joint-stock companies, or associations, and insurance companies, in whatever capacity acting, including lessees or mortgagors of real or personal property, trustees acting in any trust

capacity, executors, administrators, receivers, conservators, employers, and all officers and employees of the United States having the control, receipt, custody, disposal, or payment of interest, rent, salaries, wages, premiums, annuities, compensation, remuneration, emoluments, or other fixed or determinable annual or periodical gains, profits, and income of another person, exceeding \$3,000 for any taxable year, other than income derived from dividends on capital stock, or from the net earnings of corporations and joint-stock companies or associations, or insurance companies, the income of which is taxable under this title, who are required to make and render a return in behalf of another, as provided herein, to the collector of his, her, or its district, are hereby authorized and required to deduct and withhold from such annual or periodical gains, profits, and income such sum as will be sufficient to pay the normal tax imposed thereon by this title, and shall pay the amount withheld to the officer of the United States Government authorized to receive the same; and they are each hereby made personally liable for such tax, and they are each hereby indemnified against every person, corporation, association, or demand whatsoever for all payments which they shall make in pursuance and by virtue of this title.

**Exemption
Certificate
Must be
Filed with
Payer**

In all cases where the income tax of a person is withheld and deducted and paid or to be paid at the source, such person shall not receive the benefit of the personal exemption allowed in section seven of this title except by an application for refund of the tax unless he shall, not less than thirty days prior to the day on which the return of his income is due, file with the person who is required to withhold and pay tax for him a signed notice in writing claiming the benefit of such exemption, and thereupon no tax shall be withheld upon the amount of such exemption: *Provided*, That if any person for the purpose of obtaining any allowance or reduction by virtue of a claim for such exemption, either for himself or for any other person, knowingly makes any false statement or false or fraudulent representation, he shall be liable to a penalty of not exceeding \$300.

**Penalty
False Claim
for Exemption**

**Deductions
How
Obtained**

And where the income tax is paid or to be paid at the source, no person shall be allowed the benefit of any deduction provided for in sections five or six of this title unless he shall, not less than thirty days prior to the day on which the return of his income is due, either (1) file with the person who is required to withhold and pay tax for him a true and correct

return of his gains, profits, and income from all other sources, and also the deductions asked for, and the showing thus made shall then become a part of the return to be made in his behalf by the person required to withhold and pay the tax, or (2) likewise make application for deductions to the collector of the district in which return is made or to be made for him: *Provided*, That when any amount allowable as a deduction is known at the time of receipt of fixed annual or periodical income by an individual subject to tax, he may file with the person, firm, or corporation making the payment a certificate, under penalty for false claim, and in such form as shall be prescribed by the Commissioner of Internal Revenue, stating the amount of such deduction and making a claim for an allowance of the same against the amount of tax otherwise required to be deducted and withheld at the source of the income, and such certificate shall likewise become a part of the return to be made in his behalf.

Claim for
Deduction
May be
Made to
Payer

Return by
Agent

If such person is absent from the United States, or is unable owing to serious illness to make the return and application above provided for, the return and application may be made by an agent, he making oath that he has sufficient knowledge of the affairs and property of his principal to enable him to make a full and complete return, and that the return and application made by him are full and complete.

Normal Tax
Deductible
from
Coupons,
etc.
Irrespective
of Amount
of Income

(c) The amount of the normal tax hereinbefore imposed shall be deducted and withheld from fixed or determinable annual or periodical gains, profits, and income derived from interest upon bonds and mortgages, or deeds of trust or other similar obligations of corporations, joint-stock companies, associations, and insurance companies, whether payable annually or at shorter or longer periods, although such interest does not amount to \$3,000, subject to the provisions of this title requiring the tax to be withheld at the source and deducted from annual income and returned and paid to the Government.

(d) And likewise the amount of such tax shall be deducted and withheld from coupons, checks, or bills of exchange for or in payment of interest upon bonds of foreign countries and upon foreign mortgages or like obligations (not payable in the United States), and also from coupons, checks, or bills of exchange for or in payment of any dividends upon the stock or interest upon the obligations of foreign corporations, associations, and insurance companies engaged in business in foreign countries.

**Withholding
Tax**

And the tax in such cases shall be withheld, deducted, and returned for and in behalf of any person subject to the tax hereinbefore imposed, although such interest or dividends do not exceed \$3,000, by (1) any banker or person who shall sell or otherwise realize coupons, checks, or bills of exchange drawn or made in payment of any such interest or dividends (not payable in the United States), and (2) any person who shall obtain payment (not in the United States), in behalf of another of such dividends and interest by means of coupons, checks, or bills of exchange, and also (3) any dealer in such coupons who shall purchase the same for any such dividends or interest (not payable in the United States), otherwise than from a banker or another dealer in such coupons.

(e) Where the tax is withheld at the source, the benefit of the exemption and the deductions allowable under this title may be had by complying with the foregoing provisions of this section.

**License
Required by
Collectors of
Foreign
Payments**

(f) All persons, firms, or corporations undertaking as a matter of business or for profit the collection of foreign payments of such interest or dividends by means of coupons, checks, or bills of exchange shall obtain a license from the Commissioner of Internal Revenue, and shall be subject to such regulations enabling the Government to ascertain and verify the due withholding and payment of the income tax required to be withheld and paid as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe; and any person who shall knowingly undertake to collect such payments as aforesaid without having obtained a license therefor, or without complying with such regulations, shall be deemed guilty of a misdemeanor and for each offense be fined in a sum not exceeding \$5,000, or imprisoned for a term not exceeding one year, or both, in the discretion of the court.

**General
Assessment
of Income**

(g) The tax herein imposed upon gains, profits, and income not falling under the foregoing and not returned and paid by virtue of the foregoing shall be assessed by personal return under rules and regulations to be prescribed by the Commissioner of Internal Revenue and approved by the Secretary of the Treasury. The intent and purpose of this title is that all gains, profits, and income of a taxable class, as defined by this title, shall be charged and assessed with the corresponding tax, normal and additional, prescribed by this title, and said tax shall be paid by the owner of such income, or the proper representative having the receipt, custody, control, or disposal of the same. For the purpose of this title ownership or liability shall

be determined as of the year for which a return is required to be rendered.

The provisions of this title relating to the deduction and payment of the tax at the source of income shall only apply to the normal tax hereinbefore imposed upon individuals.

PART II.—ON CORPORATIONS.

Income of Corporations, etc., Subject to Tax	SEC. 10. That there shall be levied, assessed, collected, and paid annually upon the total net income received in the preceding calendar year from all sources by every corporation, joint-stock company or association, or insurance company, organized in the United States, no matter how created or organized but not
Rate	including partnerships, a tax of two per centum upon such income; and a like tax shall be levied, assessed, collected, and paid annually upon the total net income received in the preceding calendar year from all sources within the United States by every corporation, joint-stock company or association, or insurance company organized, authorized, or existing under the laws of any foreign country, including interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise, and including the income derived from dividends on capital stock or from net earnings of resident corporations, joint-stock companies or associations, or insurance companies whose net income is taxable under this title: <i>Provided</i> , That the term "dividends" as used in this title shall be held to mean any distribution made or ordered to be made by a corporation, joint-stock company, association, or insurance company, out of its earnings or profits accrued since March first, nineteen hundred and thirteen, and payable to its shareholders, whether in cash or in stock of the corporation, joint-stock company, association, or insurance company, which stock dividend shall be considered income, to the amount of its cash value.
Dividends Defined	
Calendar or Fiscal Year	The foregoing tax rate shall apply to the total net income received by every taxable corporation, joint-stock company or association, or insurance company in the calendar year nineteen hundred and sixteen and in each year thereafter, except that if it has fixed its own fiscal year under the provisions of existing law, the foregoing rate shall apply to the proportion of the total net income returned for the fiscal year ending prior to December thirty-first, nineteen hundred and sixteen, which the period between January first, nineteen hundred and sixteen, and the end of such fiscal year bears to the whole of such fiscal year, and the rate fixed in Section II of the Act approved October third, nineteen hundred and thirteen, entitled "An Act

to reduce tariff duties and to provide revenue for the Government, and for other purposes," shall apply to the remaining portion of the total net income returned for such fiscal year.

Ascertaining Profit or Loss For the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition by a corporation, joint-stock company or association, or insurance company, of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such gain derived or loss sustained.

CONDITIONAL AND OTHER EXEMPTIONS.

Organizations Not Taxable SEC. 11. (a) That there shall not be taxed under this title any income received by any—

First. Labor, agricultural, or horticultural organization.

Second. Mutual savings bank not having a capital stock represented by shares;

Third. Fraternal beneficiary society, order, or association, operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association or their dependents;

Fourth. Domestic building and loan association and cooperative banks without capital stock organized and operated for mutual purposes and without profit;

Fifth. Cemetery company owned and operated exclusively for the benefit of its members;

Sixth. Corporation or association organized and operated exclusively for religious, charitable, scientific, or educational purposes, no part of the net income of which inures to the benefit of any private stockholder or individual;

Seventh. Business league, chamber of commerce, or board of trade, not organized for profit and no part of the net income of which inures to the benefit of any private stockholder or individual;

Eighth. Civic league or organization not organized for profit but operated exclusively for the promotion of social welfare;

Ninth. Club organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net income of which inures to the benefit of any private stockholder or member;

Tenth. Farmers' or other mutual hail, cyclone, or fire insur-

ance company, mutual ditch or irrigation company, mutual or cooperative telephone company, or like organization of a purely local character, the income of which consists solely of assessments, dues, and fees collected from members for the sole purpose of meeting its expenses;

Eleventh. Farmers', fruit growers', or like association, organized and operated as a sales agent for the purpose of marketing the products of its members and turning back to them the proceeds of sales, less the necessary selling expenses, on the basis of the quantity of produce furnished by them;

Twelfth. Corporation or association organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt from the tax imposed by this title; or

Thirteenth. Federal land banks and national farm-loan associations as provided in section twenty-six of the Act approved July seventeenth, nineteen hundred and sixteen, entitled "An Act to provide capital for agricultural development, to create standard forms of investment based upon farm mortgage, to equalize rates of interest upon farm loans, to furnish a market for United States bonds, to create Government depositaries and financial agents for the United States, and for other purposes."

Fourteenth. Joint stock land banks as to income derived from bonds or debentures of other joint stock land banks or any Federal land bank belonging to such joint stock land bank.

Income from
Public
Utility

(b) There shall not be taxed under this title any income derived from any public utility or from the exercise of any essential governmental function accruing to any State, Territory, or the District of Columbia, or any political subdivision of a State or Territory, nor any income accruing to the government of the Philippine Islands or Porto Rico, or of any political subdivision of the Philippine Islands or Porto Rico: *Provided*, That whenever any State, Territory, or the District of Columbia, or any political subdivision of a State or Territory, has, prior to the passage of this title, entered in good faith into a contract with any person or corporation, the object and purpose of which is to acquire, construct, operate, or maintain a public utility, no tax shall be levied under the provisions of this title upon the income derived from the operation of such public utility, so far as the payment thereof will impose a loss or burden upon such State, Territory, or the District of Columbia, or a political subdivision of a State or Territory; but this provision

State and
Municipal
Income
Exempt

is not intended to confer upon such person or corporation any financial gain or exemption or to relieve such person or corporation from the payment of a tax as provided for in this title upon the part or portion of the said income to which such person or corporation shall be entitled under such contract.

DEDUCTIONS.

Deductions Allowed to Domestic Corporations

SEC. 12. (a) In the case of a corporation, joint-stock company or association, or insurance company, organized in the United States, such net income shall be ascertained by deducting from the gross amount of its income received within the year from all sources—

Necessary Expenses

First. All the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties, including rentals or other payments required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity.

Losses

Second. All losses actually sustained and charged off within the year and not compensated by insurance or otherwise, including a reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business or trade; (a) in the case of oil and gas wells a reasonable allowance for actual reduction in flow and production to be ascertained not by the flush flow, but by the settled production or regular flow; (b) in the case of mines a reasonable allowance for depletion thereof not to exceed the market value in the mine of the product thereof which has been mined and sold during the year for which the return and computation are made, such reasonable allowance to be made in the case of both (a) and (b) under rules and regulations to be prescribed by the Secretary of the Treasury: *Provided*, That when the allowance

Depreciation

Depletion

Limitation of Depletion

authorized in (a) and (b) shall equal the capital originally invested, or in case of purchase made prior to March first, nineteen hundred and thirteen, the fair market value as of that date, no further allowance shall be made; and (c) in the case of insurance companies, the net addition, if any, required by law to be made within the year to reserve funds and the sums other than dividends paid within the year on policy and annuity contracts: *Provided*, That no deduction shall be allowed for any amount paid out for new buildings, permanent improvements, or betterments made to increase the value of any property or estate, and no deduction shall be made for any

Improvements

Income of
Mutual
Companies

amount of expense of restoring property or making good the exhaustion thereof for which an allowance is or has been made: *Provided further*, That mutual fire and mutual employers' liability and mutual workmen's compensation and mutual casualty insurance companies requiring their members to make premium deposits to provide for losses and expenses shall not return as income any portion of the premium deposits returned to their policyholders, but shall return as taxable income all income received by them from all other sources plus such portions of the premium deposits as are retained by the companies for purposes other than the payment of losses and expenses and reinsurance reserves: *Provided further*, That mutual marine insurance companies shall include in their return of gross income gross premiums collected and received by them less amounts paid for reinsurance, but shall be entitled to include in deductions from gross income amounts repaid to policyholders on account of premiums previously paid by them and interest paid upon such amounts between the ascertainment thereof and the payment thereof, and life insurance companies shall not include as income in any year such portion of any actual premium received from any individual policyholder as shall have been paid back or credited to such individual policyholder, or treated as an abatement of premium of such individual policyholder, within such year;

Interest
Limitation
of Interest
Deductible

Third. The amount of interest paid within the year on its indebtedness to an amount of such indebtedness not in excess of the sum of (a) the entire amount of the paid-up capital stock outstanding at the close of the year, or, if no capital stock, the entire amount of capital employed in the business at the close of the year, and (b) one-half of its interest-bearing indebtedness then outstanding: *Provided*, That for the purpose of this title preferred capital stock shall not be considered interest-bearing indebtedness, and interest or dividends paid upon this stock shall not be deductible from gross income: *Provided further*, That in cases wherein shares of capital stock are issued without par or nominal value, the amount of paid-up capital stock, within the meaning of this section, as represented by such shares, will be the amount of cash, or its equivalent, paid or transferred to the corporation as a consideration for such shares: *Provided further*, That in the case of indebtedness wholly secured by property collateral, tangible or intangible, the subject of sale or hypothecation in the ordinary business of such corporation, joint-stock company or association as a dealer only in the property constituting such collateral, or in loaning the

funds thereby procured, the total interest paid by such corporation, company, or association within the year on any such indebtedness may be deducted as a part of its expenses of doing business, but interest on such indebtedness shall only be deductible on an amount of such indebtedness not in excess of the actual value of such property collateral: *Provided further*, That in the case of bonds or other indebtedness, which have been issued with a guaranty that the interest payable thereon shall be free from taxation, no deduction for the payment of the tax herein imposed, or any other tax paid pursuant to such guaranty, shall be allowed; and in the case of a bank, banking association, loan or trust company, interest paid within the year on deposits or on moneys received for investment and secured by interest-bearing certificates of indebtedness issued by such bank, banking association, loan or trust company;

Taxes

Fourth. Taxes paid within the year imposed by the authority of the United States, or its Territories, or possessions, or any foreign country, or under the authority of any State, county, school district, or municipality, or other taxing subdivision of any State, not including those assessed against local benefits.

Income of Foreign Corporations

(b) In the case of a corporation, joint-stock company or association, or insurance company, organized, authorized, or existing under the laws of any foreign country, such net income shall be ascertained by deducting from the gross amount of its income received within the year from all sources within the United States—

Deductions Allowed Foreign Corporations

First. All the ordinary and necessary expenses actually paid within the year out of earnings in the maintenance and operation of its business and property within the United States, including rentals or other payments required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity.

Losses

Second. All losses actually sustained within the year in business or trade conducted by it within the United States and not compensated by insurance or otherwise, including a reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business or trade;

Depreciation

Depletion

(a) and in the case (a) of oil and gas wells a reasonable allowance for actual reduction in flow and production to be ascertained not by the flush flow, but by the settled production or regular flow; (b) in the case of mines a reasonable allowance

**Limitation
of Depletion**

for depletion thereof not to exceed the market value in the mine of the product thereof which has been mined and sold during the year for which the return and computation are made, such reasonable allowance to be made in the case of both (a) and (b) under rules and regulations to be prescribed by the Secretary of the Treasury: *Provided*, That when the allow-

Improvements

ance authorized in (a) and (b) shall equal the capital originally invested, or in case of purchase made prior to March first, nineteen hundred and thirteen, the fair market value as of that date, no further allowance shall be made; and (c) in the case of insurance companies, the net addition, if any, required by law to be made within the year to reserve funds and the sums other than dividends paid within the year on policy and annuity contracts: *Provided*, That no deduction shall be allowed for

**Mutual
Companies**

any amount paid out for new buildings, permanent improvements, or betterments, made to increase the value of any property or estate, and no deduction shall be made for any amount of expense of restoring property or making good the exhaustion thereof for which an allowance is or has been made: *Provided, further*, That mutual fire and mutual employers' liability and mutual workmen's compensation and mutual casualty insurance companies requiring their members to make premium deposits to provide for losses and expenses shall not return as income any portion of the premium deposits returned to their policyholders, but shall return as taxable income all income received by them from all other sources plus such portions of the premium deposits as are retained by the companies for purposes other than the payment of losses and expenses and reinsurance reserves: *Provided further*, That mutual marine insurance companies shall include in their return of gross income gross premiums collected and received by them less amounts paid for reinsurance, but shall be entitled to include in deductions from gross income amounts repaid to policyholders on account of premiums previously paid by them, and interest paid upon such amounts between the ascertainment thereof and the payment thereof, and life insurance companies shall not include as income in any year such portion of any actual premium received from any individual policyholder as shall have been paid back or credited to such individual policyholder, or treated as an abatement of premium of such individual policyholder, within such year;

Interest

Third. The amount of interest paid within the year on its indebtedness to an amount of such indebtedness not in excess of the proportion of the sum of (a) the entire amount of the

Limitation of Interest Deductible paid-up capital stock outstanding at the close of the year, or, if no capital stock, the entire amount of the capital employed in the business at the close of the year, and (b) one-half of its interest-bearing indebtedness then outstanding, which the gross amount of its income for the year from business transacted and capital invested within the United States bears to the gross amount of its income derived from all sources within and without the United States: *Provided*, That in the case of bonds or other indebtedness which have been issued with a guaranty that the interest payable thereon shall be free from taxation, no deduction for the payment of the tax herein imposed or any other tax paid pursuant to such guaranty shall be allowed; and in case of a bank, banking association, loan or trust company, or branch thereof, interest paid within the year on deposits by or on moneys received for investment from either citizens or residents of the United States and secured by interest-bearing certificates of indebtedness issued by such bank, banking association, loan or trust company, or branch thereof;

Taxes Fourth. Taxes paid within the year imposed by the authority of the United States, or its Territories, or possessions, or under the authority of any State, county, school district, or municipality, or other taxing subdivision of any State, paid within the United States, not including those assessed against local benefits.

Reserve Insurance Companies not Deductible (c) In the case of assessment insurance companies, whether domestic or foreign, the actual deposit of sums with State or Territorial officers, pursuant to law, as additions to guarantee or reserve funds shall be treated as being payments required by law to reserve funds.

RETURNS.

Tax Year SEC. 13. (a) The tax shall be computed upon the net income, as thus ascertained, received within each preceding calendar year ending December thirty-first: *Provided*, That any corporation, joint-stock company or association, or insurance company, subject to this tax, may designate the last day of any month in the year as the day of the closing of its fiscal year and shall be entitled to have the tax payable by it computed upon the basis of the net income ascertained as herein provided for the year ending on the day so designated in the year preceding the date of assessment instead of upon the basis of the net income for the calendar year preceding the date of assessment; and it shall give notice of the day it has thus designated

Fiscal Year

as the closing of its fiscal year to the collector of the district in which its principal business office is located at any time not less than thirty days prior to the first day of March of the year in which its return would be filed if made upon the basis of the calendar year;

Return when
Due

(b) Every corporation, joint-stock company or association, or insurance company, subject to the tax herein imposed, shall, on or before the first day of March, nineteen hundred and seventeen, and the first day of March in each year thereafter, or, if it has designated a fiscal year for the computation of its tax, then within sixty days after the close of such fiscal year ending prior to December thirty-first, nineteen hundred and sixteen, and the close of each such fiscal year thereafter, render a true and accurate return of its annual net income in the manner and form to be prescribed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, and containing such facts, data, and information as are appropriate and in the opinion of the commissioner necessary to determine the correctness of the net income returned and to carry out the provisions of this title. The return shall be sworn to by the president, vice president, or other principal officer, and by the treasurer or assistant treasurer. The return shall be made to the collector of the district in which is located the principal office of the corporation, company, or association, where are kept its books of account and other data from which the return is prepared, or in the case of a foreign corporation, company, or association, to the collector of the district in which is located its principal place of business in the United States, or if it have no principal place of business, office, or agency in the United States, then to the collector of internal revenue at Baltimore, Maryland. All such returns shall as received be transmitted forthwith by the collector to the Commissioner of Internal Revenue;

Sworn to
by Two
Officers of
Corporation

Where to
File Return

Receivers,
Trustees, etc.,
Must Make
Returns

(c) In cases wherein receivers, trustees in bankruptcy, or assignees are operating the property or business of corporations, joint-stock companies or associations, or insurance companies, subject to tax imposed by this title, such receivers, trustees, or assignees shall make returns of net income as and for such corporations, joint-stock companies or associations, and insurance companies, in the same manner and form as such organizations are hereinbefore required to make returns, and any income tax due on the basis of such returns made by receivers, trustees, or assignees shall be assessed and collected

in the same manner as if assessed directly against the organizations of whose businesses or properties they have custody and control;

Basis of Keeping Accounts

(d) A corporation, joint-stock company or association, or insurance company, keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect its income, may, subject to regulations made by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, make its return upon the basis upon which its accounts are kept, in which case the tax shall be computed upon its income as so returned;

Withholding Tax

(e) All the provisions of this title relating to the tax authorized and required to be deducted and withheld and paid to the officer of the United States Government authorized to receive the same from the income of nonresident alien individuals from sources within the United States shall be made

Interest

applicable to incomes derived from interest upon bonds and mortgages or deeds of trust or similar obligations of domestic or other resident corporations, joint-stock companies or associations,

Nonresident Organizations

and insurance companies by nonresident alien firms, copartnerships, companies, corporations, joint-stock companies or associations, and insurance companies not engaged in business or trade within the United States and not having any office or place of business therein;

Dividends

(f) Likewise, all the provisions of this title relating to the tax authorized and required to be deducted and withheld and paid to the officer of the United States Government authorized to receive the same from the income of nonresident alien individuals from sources within the United States shall be made applicable to income derived from dividends upon the capital stock or from the net earnings of domestic or other resident corporations, joint-stock companies or associations, and insurance companies by nonresident alien companies, corporations,

Nonresident Organizations

joint-stock companies or associations, and insurance companies not engaged in business or trade within the United States and not having any office or place of business therein.

ASSESSMENT AND ADMINISTRATION.

Assessments

SEC. 14. (a) All assessments shall be made and the several corporations, joint-stock companies or associations, and insurance companies shall be notified of the amount for which they are respectively liable on or before the first day of June of each successive year, and said assessment shall be paid on or

**Payment of
Tax When
Due**

before the fifteenth day of June; *Provided*, That every corporation, joint-stock company or association, and insurance company, computing taxes upon the income of the fiscal year which it may designate in the manner hereinbefore provided, shall pay the taxes due under its assessment within one hundred and five days after the date upon which it is required to file its list or return of income for assessment; except in cases of refusal or neglect to make such return, and in cases of erroneous, false, or fraudulent returns, in which cases the Commissioner of Internal Revenue shall, upon the discovery thereof, at any time within three years after said return is due, make a return upon information obtained as provided for in this title or by existing law; and the assessment made by the Commissioner of Internal Revenue thereon shall be paid by such corporation, joint-stock company or association, or insurance company immediately upon notification of the amount of such assessment; and to any sum or sums due and unpaid after the fifteenth day of June in any year, or after one hundred and five days from the date on which the return of income is required to be made by the taxpayer, and after ten days' notice and demand thereof by the collector, there shall be added the sum of five per centum on the amount of tax unpaid and interest at the rate of one per centum per month upon said tax from the time the same becomes due; *Provided*, That upon the examination of any return of income made pursuant to this title, the Act of August fifth, nineteen hundred and nine, entitled, "An Act to provide revenue, equalize duties and encourage the industries of the United States, and for other purposes," and the Act of October third, nineteen hundred and thirteen, entitled, "An Act to reduce tariff duties and to provide revenue for the Government, and for other purposes," if it shall appear that amounts of tax have been paid in excess of those properly due, the taxpayer shall be permitted to present a claim for refund thereof notwithstanding the provisions of section thirty-two hundred and twenty-eight of the Revised Statutes;

**Penalty
Delayed
Payment**

**Returns
Constitute
Public
Records**

(b) When the assessment shall be made, as provided in this title, the returns, together with any corrections thereof which may have been made by the commissioner, shall be filed in the office of the Commissioner of Internal Revenue and shall constitute public records and be open to inspection as such; *Provided*, That any and all such returns shall be open to inspection only upon the order of the President, under rules and regulations to be prescribed by the Secretary of the Treasury and approved by the President; *Provided further*, That the proper officers of any State imposing a general income tax may, upon

**Conditions of
Inspection**

the request of the governor thereof, have access to said returns or to an abstract thereof, showing the name and income of each such corporation, joint-stock company or association, or insurance company, at such times and in such manner as the Secretary of the Treasury may prescribe;

**Penalty
Refusal to
Make Return
and Making
False Return**

(c) If any of the corporations, joint-stock companies or associations, or insurance companies aforesaid shall refuse or neglect to make a return at the time or times hereinbefore specified in each year, or shall render a false or fraudulent return, such corporation, joint-stock company or association, or insurance company shall be liable to a penalty of not exceeding \$10,000; *Provided*, That the Commissioner of Internal Revenue shall have authority, in the case of either corporations or individuals, to grant a reasonable extension of time in meritorious cases, as he may deem proper.

(d) That section thirty-two hundred and twenty-five of the Revised Statutes of the United States be, and the same is hereby, amended so as to read as follows:

**Second
Assessment**

"SEC. 3225. When a second assessment is made in case of any list, statement, or return, which in the opinion of the collector or deputy collector was false or fraudulent, or contained any understatement or undervaluation, no tax collected under such assessment shall be recovered by any suit unless it is proved that the said list, statement, or return was not false nor fraudulent and did not contain any understatement or undervaluation; but this section shall not apply to statements or returns made or to be made in good faith under the laws of the United States, regarding annual depreciation of oil or gas wells and mines."

PART III.—GENERAL ADMINISTRATIVE PROVISIONS.

**"State"
"United
States"
Defined**

SEC. 15. That the word "State" or "United States" when used in this title shall be construed to include any Territory, the District of Columbia, Porto Rico, and the Philippine Islands, when such construction is necessary to carry out its provisions.

SEC. 16. That sections thirty-one hundred and sixty-seven, thirty-one hundred and seventy-two, thirty-one hundred and seventy-three, and thirty-one hundred and seventy-six of the Revised Statutes of the United States as amended are hereby amended so as to read as follows:

**Disclosing
Information
Prohibited**

"SEC. 3167. It shall be unlawful for any collector, deputy collector, agent, clerk, or other officer or employee of the United States to divulge or to make known in any manner whatever

not provided by law to any person the operations, style of work, or apparatus of any manufacturer or producer visited by him in the discharge of his official duties, or the amount or source of income, profits, losses, expenditures, or any particular thereof, set forth or disclosed in any income return, or to permit any income return or copy thereof or any book containing any abstract or particulars thereof to be seen or examined by any person except as provided by law; and it shall be unlawful for any person to print or publish in any manner whatever not provided by law any income return or any part thereof or source of income, profits, losses, or expenditures appearing in any income return; and any offense against the foregoing provision shall be a misdemeanor and be punished by a fine not exceeding \$1,000 or by imprisonment not exceeding one year, or both, at the discretion of the court; and if the offender be an officer or employee of the United States he shall be dismissed from office or discharged from employment.

"SEC. 3172. Every collector shall, from time to time, cause his deputies to proceed through every part of his district and inquire after and concerning all persons therein who are liable to pay any internal-revenue tax, and all persons owning or having the care and management of any objects liable to pay any tax, and to make a list of such persons and enumerate said objects.

Provisions of
Administra-
tion

"SEC. 3173. It shall be the duty of any person, partnership, firm, association, or corporation, made liable to any duty, special tax, or other tax imposed by law, when not otherwise provided for, (1) in case of a special tax, on or before the thirty-first day of July in each year, (2) in case of income tax on or before the first day of March in each year, or on or before the last day of the sixty-day period next following the closing date of the fiscal year for which it makes a return of its income, and (3) in other cases before the day on which the taxes accrue, to make a list or return, verified by oath, to the collector or a deputy collector of the district where located, of the articles or objects, including the amount of annual income charged with a duty or tax, the quantity of goods, wares, and merchandise, made or sold and charged with a tax, the several rates and aggregate amount, according to the forms and regulations to be prescribed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, for which such person, partnership, firm, association, or corporation is liable: *Provided*, That if any person liable to pay any duty or tax, or owning, possessing, or having the care or management of property, goods, wares, and merchandise, article or objects liable

to pay any duty, tax, or license, shall fail to make and exhibit a list or return required by law, but shall consent to disclose the particulars of any and all the property, goods, wares, and merchandise, articles, and objects liable to pay any duty or tax, or any business or occupation liable to pay any tax as aforesaid, then, and in that case, it shall be the duty of the collector or deputy collector to make such list or return, which, being distinctly read, consented to, and signed and verified by oath by the person so owning, possessing, or having the care and management as aforesaid, may be received as the list of such person: *Provided further*, That in case no annual list or return has been rendered by such person to the collector or deputy collector as required by law, and the person shall be absent from his or her residence or place of business at the time the collector or a deputy collector shall call for the annual list or return, it shall be the duty of such collector or deputy collector to leave at such place of residence or business, with some one of suitable age and discretion, if such be present, otherwise to deposit in the nearest post office, a note or memorandum addressed to such person, requiring him or her to render to such collector or deputy collector the list or return required by law within ten days from the date of such note or memorandum, verified by oath. And if any person, on being notified or required as aforesaid, shall refuse or neglect to render such list or return within the time required as aforesaid, or whenever any person who is required to deliver a monthly or other return of objects subject to tax fails to do so at the time required, or delivers any return which, in the opinion of the collector, is erroneous, false, or fraudulent, or contains any undervaluation or understatement, or refuses to allow any regularly authorized Government officer to examine the books of such person, firm, or corporation, it shall be lawful for the collector to summon such person, or any other person having possession, custody, or care of books of account containing entries relating to the business of such person, or any other person he may deem proper, to appear before him and produce such books at a time and place named in the summons, and to give testimony or answer interrogatories, under oath, respecting any objects or income liable to tax or the returns thereof. The collector may summon any person residing or found within the State or Territory in which his district lies; and when the person intended to be summoned does not reside and can not be found within such State or Territory, he may enter any collection district where such person may be found

and there make the examination herein authorized. And to this end he may there exercise all the authority which he might lawfully exercise in the district for which he was commissioned; *Provided*, That 'person,' as used in this section, shall be construed to include any corporation, joint-stock company or association, or insurance company when such construction is necessary to carry out its provisions.

When
collector
may Prepare
return

"SEC. 3176. If any person, corporation, company, or association fails to make and file a return or list at the time prescribed by law, or makes, willfully or otherwise, a false or fraudulent return or list, the collector or deputy collector shall make the return or list from his own knowledge and from such information as he can obtain through testimony or otherwise. Any return or list so made and subscribed by a collector or deputy collector shall be *prima facie* good and sufficient for all legal purposes.

Extension of
time

"If the failure to file a return or list is due to sickness or absence the collector may allow such further time, not exceeding thirty days, for making and filing the return or list as he deems proper.

Penalties for
failure to
file Returns

"The Commissioner of Internal Revenue shall assess all taxes, other than stamp taxes, as to which returns or lists are so made by a collector or deputy collector. In case of any failure to make and file a return or list within the time prescribed by law or by the collector, the Commissioner of Internal Revenue shall add to the tax fifty per centum of its amount except that, when a return is voluntarily and without notice from the collector filed after such time and it is shown that the failure to file it was due to a reasonable cause and not to willful neglect, no such addition shall be made to the tax. In case a false or fraudulent return or list is willfully made, the Commissioner of Internal Revenue shall add to the tax one hundred per centum of its amount.

"The amount so added to any tax shall be collected at the same time and in the same manner and as part of the tax unless the tax has been paid before the discovery of the neglect, falsity, or fraud, in which case the amount so added shall be collected in the same manner as the tax."

Receipt for
payment of
tax

SEC. 17. That it shall be the duty of every collector of internal revenue, to whom any payment of any taxes is made under the provisions of this title, to give to the person making such payment a full written or printed receipt, expressing the amount

paid and the particular account for which such payment was made; and whenever such payment is made such collector shall, if required, give a separate receipt for each tax paid by any debtor, on account of payments made to or to be made by him to separate creditors in such form that such debtor can conveniently produce the same separately to his several creditors in satisfaction of their respective demands to the amounts specified in such receipts; and such receipts shall be sufficient evidence in favor of such debtor to justify him in withholding the amount therein expressed from his next payment to his creditor; but such creditor may, upon giving to his debtor a full written receipt, acknowledging the payment to him of whatever sum may be actually paid, and accepting the amount of tax paid as aforesaid (specifying the same) as a further satisfaction of the debt to that amount, require the surrender to him of such collector's receipt.

Penalties

SEC. 18. That if any individual liable to make the return or pay the tax aforesaid shall refuse or neglect to make such return at the time or times hereinbefore specified in each year, he shall be liable to a penalty of not less than \$20 nor more than \$1,000. Any individual or any officer of any corporation, joint-stock company or association, or insurance company required by law to make, render, sign, or verify any return who makes any false or fraudulent return or statement with intent to defeat or evade the assessment required by this title to be made shall be guilty of a misdemeanor, and shall be fined not exceeding \$2,000 or be imprisoned not exceeding one year, or both, in the discretion of the court, with the costs of prosecution; *Provided*, That where any tax heretofore due and payable has been duly paid by the taxpayer, it shall not be re-collected from any person or corporation required to retain it at its source, nor shall any penalty be imposed or collected in such cases from the taxpayer, or such person or corporation whose duty it was to retain it, for failure to return or pay the same, unless such failure was fraudulent and for the purpose of evading payment.

Returns Verified by Oath

SEC. 19. The collector or deputy collector shall require every return to be verified by the oath of the party rendering it. If the collector or deputy collector have reason to believe that the amount of any income returned is understated, he shall give due notice to the person making the return to show cause why the amount of the return should not be increased, and upon proof of the amount understated may increase the same accordingly. Such person may furnish sworn testimony to prove any

Right of Appeal relevant facts, and, if dissatisfied with the decision of the collector, may appeal to the Commissioner of Internal Revenue for his decision under such rules of procedure as may be prescribed by regulation.

Jurisdiction of District Court SEC. 20. That jurisdiction is hereby conferred upon the district courts of the United States for the district within which any person summoned under this title to appear to testify or to produce books shall reside, to compel such attendance, production of books, and testimony by appropriate process.

Statistics SEC. 21. That the preparation and publication of statistics reasonably available with respect to the operation of the income tax law and containing classifications of taxpayers and of income, the amounts allowed as deductions and exemptions, and any other facts deemed pertinent and valuable, shall be made annually by the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury.

SEC. 22. That all administrative, special, and general provisions of law, including the laws in relation to the assessment, remission, collection, and refund of internal-revenue taxes not heretofore specifically repealed and not inconsistent with the provisions of this title, are hereby extended and made applicable to all the provisions of this title and to the tax herein imposed.

Porto Rico Philippine Islands SEC. 23. That the provisions of this title shall extend to Porto Rico and the Philippine Islands; *Provided*, That the administration of the law and the collection of the taxes imposed in Porto Rico and the Philippine Islands shall be by the appropriate internal-revenue officers of those governments, and all revenues collected in Porto Rico and the Philippine Islands thereunder shall accrue intact to the general Governments thereof, respectively; *Provided further*, That the jurisdiction in this title conferred upon the district courts of the United States shall, so far as the Philippine Islands are concerned, be vested in the courts of the first instance of said islands; *And provided further*, That nothing in this title shall be held to exclude from the computation of the net income the compensation paid any official by the governments of the District of Columbia, Porto Rico, and the Philippine Islands, or the political subdivisions thereof.

Repeal of Income Tax Act of 1913 SEC. 24. That Section II of the Act approved October third, nineteen hundred and thirteen, entitled "An Act to reduce tariff duties and to provide revenue for the Government, and for other purposes," is hereby repealed, except as herein otherwise

provided, and except that it shall remain in force for the assessment and collection of all taxes which have accrued thereunder, and for the imposition and collection of all penalties or forfeitures which have accrued or may accrue in relation to any of such taxes, and except that the unexpended balance of any appropriation heretofore made and now available for the administration of such section or any provision thereof shall be available for the administration of this title or the corresponding provision thereof.

SEC. 25. That income on which has been assessed the tax imposed by Section II of the Act entitled "An Act to reduce tariff duties and to provide revenue for the Government, and for other purposes," approved October third, nineteen hundred and thirteen, shall not be considered as income within the meaning of this title; *Provided*, That this section shall not conflict with that portion of section ten, of this title, under which a taxpayer has fixed its own fiscal year.

APPENDIX B
FEDERAL CORPORATION CAPITAL STOCK
TAX LAW

ENACTED SEPTEMBER 8, 1916

SECTION 407. That on and after January first, nineteen hundred and seventeen, special taxes shall be, and hereby are, imposed annually, as follows, that is to say:

Every corporation, joint-stock company or association, now or hereafter organized in the United States for profit and having a capital stock represented by shares, and every insurance company, now or hereafter organized under the laws of the United States, or any State or Territory of the United States, shall pay annually a special excise tax with respect to the carrying on or doing business by such corporation, joint-stock company or association, or insurance company, equivalent to 50 cents for each \$1,000 of the fair value of its capital stock and in estimating the value of capital stock the surplus and undivided profits shall be included: *Provided*, That in the case of insurance companies such deposits and reserve funds as they are required by law or contract to maintain or hold for the protection of or payment to or apportionment among policyholders shall not be included. The amount of such annual tax shall in all cases be computed on the basis of the fair average value of the capital stock for the preceding year: *Provided*, That for the purpose of this tax an exemption of \$99,000 shall be allowed from the capital stock as defined in this paragraph of each corporation, joint-stock company or association, or insurance company: *Provided further*, That a corporation, joint-stock company or association, or insurance company, actually paying the tax imposed by section three hundred and one of Title III of this act shall be entitled to a credit as against the tax imposed by this paragraph equal to the amount of the tax so actually paid: *And provided further*, That this tax shall not be imposed upon any corporation, joint-stock company or association, or insurance company not engaged in business during the preceding taxable year, or which is exempt under the provisions of section eleven, Title I, of this act.

Every corporation, joint-stock company or association, or insurance company, now or hereafter organized for profit under the laws of any foreign country and engaged in business in the United States shall pay annually a special excise tax with respect

to the carrying on or doing business in the United States by such corporation, joint-stock company or association, or insurance company, equivalent to 50 cents for each \$1,000 of the capital actually invested in the transaction of its business in the United States: *Provided*, That in the case of insurance companies such deposits or reserve funds as they are required by law or contract to maintain or hold in the United States for the protection of or payment to or apportionment among policyholders, shall not be included. The amount of such annual tax shall in all cases be computed on the basis of the average amount of capital so invested during the preceding year: *Provided*, That for the purpose of this tax an exemption from the amount of capital so invested shall be allowed equal to such proportion of \$99,000 as the amount so invested bears to the total amount invested in the transaction of business in the United States or elsewhere: *Provided, further*, That this exemption shall be allowed only if such corporation, joint-stock company or association, or insurance company makes return to the Commissioner of Internal Revenue, under regulations prescribed by him, with the approval of the Secretary of the Treasury, of the amount of capital invested in the transaction of business outside the United States: *And provided further*, That a corporation, joint-stock company or association, or insurance company actually paying the tax imposed by section three hundred and one of Title III of this act, shall be entitled to a credit as against the tax imposed by this paragraph equal to the amount of the tax so actually paid: *And provided further*, That this tax shall not be imposed upon any corporation, joint-stock company or association, or insurance company not engaged in business during the preceding taxable year, or which is exempt under the provisions of section eleven, Title I, of this act.

SEC. 408. (Last paragraph.) Every person who carries on any business or occupation for which special taxes are imposed by this title, without having paid the special tax therein provided, shall, besides being liable to the payment of such special tax, be deemed guilty of a misdemeanor, and upon conviction thereof shall pay a fine of not more than \$500, or be imprisoned not more than six months, or both, in the discretion of the court.

SEC. 409. That all administrative or special provisions of law, including the law relating to the assessment of taxes, so far as applicable, are hereby extended to and made a part of this title, and every person, firm, company, corporation, or association liable to any tax imposed by this title, shall keep such records and render, under oath, such statements and returns, and shall comply with such regulations as the Commissioner of Internal Rev-

enue, with the approval of the Secretary of the Treasury, may from time to time prescribe.

REGULATIONS.

Concerning the special excise tax imposed by section 407, Title IV, act of September 8, 1916, on corporations, joint-stock companies or associations, and insurance companies, organized for profit in the United States, and on the capital invested in the United States of foreign companies and associations transacting business in the United States.

RETURNS COMPUTATION OF TAX, COLLECTIONS, AND PENALTIES.

Tax imposed.

Article 1. Section 407 imposes a special excise tax with respect to the carrying on or doing business by corporations, joint-stock companies or associations, or insurance companies, as follows:

Corporations in the United States.

(a) Every corporation, joint-stock company or association, or insurance company, now or hereafter organized in the United States for profit and having a capital stock represented by shares, 50 cents for each \$1,000 of the fair value of the capital stock in excess of \$99,000, except as hereinafter indicated; and

Foreign corporations.

(b) Every corporation, joint-stock company or association, or insurance company, now or hereafter organized for profit under the laws of any foreign country and engaged in business in the United States, 50 cents for each \$1,000 of the capital actually invested in the transaction of its business in the United States. It is provided in cases in which the foreign corporation makes a return of the total amount of capital invested in the transaction of business, both abroad and in this country, that such proportion of \$99,000 as the amount invested in the United States bears to the total amount invested in the United States and elsewhere may be remitted in computing the tax upon the capital invested in the United States.

Corporations Exempt.

Corporations and associations exempt.

Art. 2. (a) The following corporations, joint-stock companies or associations, or insurance companies, which are exempt from income tax under the provisions of section 11,

Title I, are also specifically exempt from the capital-stock tax under section 407, Title IV, of this act:

First. Labor, agricultural, or horticultural organization;

Second. Mutual savings bank not having a capital stock represented by shares;

Third. Fraternal beneficiary society, order, or association, operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association, or their dependents;

Fourth. Domestic building and loan association and cooperative banks without capital stock organized and operated for mutual purposes and without profit;

Fifth. Cemetery company owned and operated exclusively for the benefit of its members;

Sixth. Corporation or association organized and operated exclusively for religious, charitable, scientific, or educational purposes, no part of the net income of which inures to the benefit of any private stockholder or individual;

Seventh. Business league, chamber of commerce, or board of trade, not organized for profit and no part of the net income of which inures to the benefit of any private stockholder or individual;

Eighth. Civic league or organization not organized for profit but operated exclusively for the promotion of social welfare;

Ninth. Club organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net income of which inures to the benefit of any private stockholder or member;

Tenth. Farmers' or other mutual hail, cyclone, or fire insurance company, mutual ditch or irrigation company, mutual or cooperative telephone company, or like organization of a purely local character, the income of which consists solely of assessments, dues, and fees collected from members for the sole purpose of meeting its expenses;

Eleventh. Farmers', fruit growers', or like association, organized and operated as a sales agent for the purpose of marketing the products of its members and turning back to them the proceeds of sales, less the necessary selling expenses, on the basis of the quantity of produce furnished by them;

Twelfth. Corporation or association organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less

expenses, to an organization which itself is exempt from the tax imposed by this title; or

Thirteenth. Federal land banks and national farm-loan associations as provided in section twenty-six of the act approved July seventeenth, nineteen hundred and sixteen, entitled "An act to provide capital for agricultural development, to create standard forms of investment based upon farm mortgage, to equalize rates of interest upon farm loans, to furnish a market for United States bonds, to create Government depositaries and financial agents for the United States, and for other purposes."

Mutual companies exempt.

(b) Inasmuch as the basis of tax is the fair value of the stock of a corporation, mutual insurance companies and other associations not having capital stock represented by shares will also be exempt from tax, in the absence of a basis for the computation of the tax.

Returns.

Tax due in January and July, 1917, and annually in July thereafter.

Art. 3. (a) Section 3237, Revised Statutes, as amended by section 53 of the act of October 1, 1890 (26 Stats., 567), provides "that all special taxes shall become due on the 1st day of July, 1891, and on the 1st day of July in each year thereafter, or on commencing any trade or business on which such tax is imposed. In the former case the tax shall be reckoned for one year, and in the latter case it shall be reckoned proportionately from the 1st day of the month in which the liability to a special tax commenced to the 1st day of July following." The capital-stock tax, therefore, which becomes effective January 1, 1917, will be payable in January, 1917, on returns to be made during that month for the six months ending June 30, 1917. In July, 1917, and annually in July thereafter, returns must again be made and the tax paid for the ensuing fiscal year.

Returns required of every United States corporation having capital stock outstanding of \$75,000 or over.

(b) Every corporation, joint-stock company or association, or insurance company, organized in the United States for profit and having a capital stock issued and outstanding, represented by shares of the market value of \$75,000 or over, and not exempt as indicated in article 2, shall make a return on Form

707 irrespective of the par value of its capital stock, unless such corporation, joint-stock company or association, or insurance company was not engaged in business during the preceding taxable year, which for the return due January 1, 1917, shall be the fiscal year July 1, 1915, to June 30, 1916.

Return required of every foreign corporation.

(c) Every corporation, joint-stock company or association, or insurance company, organized for profit under the laws of any foreign country and engaged in business in the United States, shall make return on Form 708 irrespective of the amount of capital employed either at home or in this country in the transaction of its business.

Form of return for United States corporations.

Substance of return required from United States Corporations.

Art. 4. The return required by article 3 of corporations, joint-stock companies or associations, or insurance companies, organized in the United States, shall be made on Form 707, to be supplied by this department, and shall set forth the following particulars:

- (1) Total number of shares of stock now outstanding.
- (2) Par value of shares.
- (3) Par value of total capital stock outstanding.
- (4) Amount of surplus.
- (5) Amount of undivided profits.

(6) *Case I.*—Average market value per share during preceding fiscal year, if stock is listed on an exchange.

Case II.—If stock is not listed on an exchange, average market value per share computed from sales made during preceding fiscal year.

Case III.—If stock is not listed on any exchange and no sales have been made during preceding fiscal year, or if sales have been made and the price is unknown, the fair average value of the stock may be estimated from the following data set forth on the return: Amount of surplus, amount of undivided profits, nature of business, estimated earning capacity, average dividends per share paid during preceding five years, average profits per share earned during preceding five years.

(7) Total number of shares of stock outstanding on last day of fiscal year.

(8) Fair value of total capital stock for preceding fiscal year.

(9) Deduction allowed by law of \$99,000.

(10) Amount of fair value of stock over \$99,000 upon which tax should be computed.

(11) Tax at rate of 50 cents per year for each full \$1,000.

(12) Amount of munitions tax, if any, paid under Title III of this act since making the last previous return.

(13) Amount of tax due.

Form of return for foreign corporations.

Substance of return required of foreign corporations.

Art. 5. The return required by article 3 of foreign corporations, joint-stock companies or associations, or insurance companies, having capital invested in the transaction of its business in the United States, shall be made on Form 708, to be supplied by this department, and shall set forth the following particulars:

(1) Amount of capital invested in the United States.

(2) Amount of capital invested in foreign countries.

(3) Total amount of capital invested in the corporation, both in the United States and elsewhere.

(4) Percentage of capital invested in the United States.

(5) Percentage of \$99,000 allowed to be deducted under the law.

(6) Amount of capital upon which tax should be computed.

(7) Tax at the rate of 50 cents per year for each full \$1,000.

(8) Amount of munitions tax, if any, paid under Title III of this act since making the last previous return.

(9) Amount of tax due.

Computation of Tax.

United States corporations.

Art. 6. Sec. 1. Companies or associations organized in the United States for profit.—The tax on companies or associations having a capital stock represented by shares is imposed on the fair average value for the preceding year and not the face or par value of the capital stock. The fair value of the capital stock shall be ascertained as follows:

Stock listed on exchange.

(a) *Case I.*—If the stock is listed on any exchange its fair value will be determined by adding the quoted highest bid price for the stock on the last business day of each month during the preceding fiscal year (or if no bid price was quoted on the last day then the latest day in the month on which a bid was quoted), and dividing by 12, the result being the average bid price per share for that year.

Stock not listed, but of which sales have been made.

(b) *Case II.*—If the stock is not listed on any exchange, but sales thereof have been actually made, and the price paid for the stock is known to the officer making the return, or can be discovered by him, the average price at which sales were made during the preceding fiscal year shall be the determining factor in ascertaining the fair value per share.

(In the foregoing two cases the actual fair value of the stock is ascertainable from the facts without the necessity of making an estimate.)

Cases in which fair average value of stock shall be estimated.

(c) *Case III.*—If Case I and Case II can not be applied, viz., the stock is not listed on any exchange, and no actual sales have been made during the preceding fiscal year, or if the price at which sales have been made is not known to the officer making the return the fair average value of the capital stock shall be estimated, and the surplus and undivided profits for the preceding fiscal year will be taken into consideration as required by the statute, as well as the nature of the business, its earning capacity and average dividends paid, or profits earned during the preceding five years.

Fair value of total capital stock outstanding.

(d) The fair value per share ascertained or estimated as above multiplied by the number of shares outstanding will give the fair value of the stock for taxation purposes.

Deduction of \$99,000.

(e) From this total will be deducted the sum of \$99,000, the exemption allowed by law, and the tax will be laid upon the balance at the rate of 50 cents for each full \$1,000 of the remainder.

Tax due January, 1917.

(f) Upon the returns to be made during January, 1917, for the six months ending June 30, 1917, the tax due will be 25 cents per \$1,000 of such remainder.

Deduction of munitions tax.

(g) From the tax due as so determined will be deducted the amount of munitions tax, if any, actually paid since making the last previous return. As the special excise tax on capital stock is due in January, 1917, and the munitions tax will not be determined and assessed until March or April, no deductions for munitions tax will be allowed on the January, 1917, return. De-

ductions, however, will be allowed on the July, 1917, return for munitions taxes actually paid prior to that date.

SEC. 2. *Corporations, joint-stock companies or associations, or insurance companies, organized for profit under the laws of any foreign country and engaged in business in the United States.*

Foreign corporations.

(a) The tax imposed on such companies or associations shall be computed upon the actual capital invested in the transaction of its business in the United States. The basis of taxation is the *average* amount of capital so invested during the preceding fiscal year.

Deduction of proportion of \$99,000 only allowed if corporation makes return of total capital invested.

(b) The exemption from the amount of capital invested in the United States equal to the proportion of \$99,000 as the amount so invested bears to the total amount invested in the transaction of business in the United States or elsewhere shall only be allowed a company or association which makes return to the Commissioner of Internal Revenue, under these regulations, of the amount of capital invested in the transaction of business outside of the United States. Thus a foreign company or association investing part of its capital in the transaction of business in the United States shall be liable for tax in the amount of 50 cents for each \$1,000 of the actual capital invested in the United States, without deduction of the said proportion of \$99,000, unless it discloses in its return the amount of capital invested in the transaction of business outside of the United States.

Corporations not in business during preceding taxable year.

SEC. 3. *Corporations not engaged in business during preceding taxable year.*—This tax shall not be imposed upon any corporation, joint-stock company or association, or insurance company not engaged in business during the preceding taxable year, or in the case of the taxable period ending June 30, 1917, not so engaged during the year July 1, 1915, to June 30, 1916. The tax shall be computed upon each full value of \$1,000 and not on any fractional part thereof.

Collection of tax.

Special list, Form 23c.

Art. 7. On account of the impracticability of issuing stamps in the various amounts, this tax will be collected by assessment on a special list for the months of January and July, 1917, and

annually thereafter in July. Any delinquent returns made in February or other months, or any assessments for delinquency in taxes, may be listed on the regular list Form 23, and collected in the usual way.

Returns retained by collector.

(a) Returns listed on special lists will be retained in the office of the collector as the special list will be prepared so as to give the essential data shown by the return.

Returns forwarded to commissioner.

(b) Returns listed on regular lists will be forwarded to this office with the list for audit.

Penalty of 5 per cent.

(c) Upon failure to pay the tax assessed within 10 days, after notice and demand, a penalty of 5 per cent. of the tax unpaid and interest at the rate of 1 per cent. per month until paid shall be added to the amount of such tax.

Penalties.

Administrative and assessment laws applicable to this law.

Art. 8. (a) Under section 409 it is provided that "all administrative or special provisions of law, including the law relating to the assessment of taxes so far as applicable, are hereby extended to and made a part of Title IV, and every person, firm, company, corporation, or association liable to any tax imposed by this title shall keep such records and render under oath such statements and returns as shall comply with such regulations as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may from time to time prescribe."

Penalties for failure to make return.

(b) Any company or association, therefore, subject to special tax under section 407 of this act, which fails to make returns during the months of January, 1917, and July, 1917, and annually in July thereafter, will be liable to the penalties imposed by section 3176, Revised Statutes, as amended by section 16, act of September 8, 1916, which reads as follows:

Collector may make the return.

If any person, corporation, company, or association fails to make and file a return or list at the time prescribed by law, or makes, wilfully or otherwise, a false or fraudulent return or list, the collector or deputy collector shall make the return or

list from his own knowledge and from such information as he can obtain through testimony or otherwise. Any return or list so made and subscribed by a collector or deputy collector shall be *prima facie* good and sufficient for all legal purposes.

Extension of 30 days.

If the failure to file a return or list is due to sickness or absence the collector may allow such further time, not exceeding thirty days, for making and filing the return or list as he deems proper.

Fifty per cent. penalty.

The Commissioner of Internal Revenue shall assess all taxes, other than stamp taxes, as to which returns or lists are so made by a collector or deputy collector. In case of any failure to make and file a return or list within the time prescribed by law or by the collector, the Commissioner of Internal Revenue shall add to the tax fifty per centum of its amount except that, when a return is voluntarily and without notice from the collector filed after such time and it is shown that the failure to file it was due to a reasonable cause and not to willful neglect, no such addition shall be made to the tax. In case a false or fraudulent return or list is willfully made, the Commissioner of Internal Revenue shall add to the tax one hundred per centum of its amount.

The amount so added to any tax shall be collected at the same time and in the same manner and as part of the tax unless the tax has been paid before the discovery of the neglect, falsity, or fraud, in which case the amount so added shall be collected in the same manner as the tax.

(c) In addition to the penalties imposed by section 3176, Revised Statutes, section 408 provides as follows:

Specific penalty.

Every person who carries on any business or occupation for which special taxes are imposed by this title, without having paid the special tax therein provided, shall, besides being liable to the payment of such special tax, be deemed guilty of a misdemeanor, and upon conviction thereof shall pay a fine of not more than \$500, or be imprisoned not more than six months, or both, in the discretion of the court.

W. H. OSBORN,

Commissioner of Internal Revenue.

Approved:

WM. P. MALBURN,

Acting Secretary of the Treasury.

APPENDIX C

COLLECTION DISTRICTS

WITH THE

NAMES AND ADDRESSES OF COLLECTORS OF INTERNAL
REVENUE

Revised to December 31, 1915

ALABAMA (Includes Mississippi), JOHN D. McNEEL, Birmingham.

ALASKA (See Washington).

ARIZONA (See New Mexico).

ARKANSAS, JACK WALKER, Little Rock.

CALIFORNIA.

First District.—The counties of Alameda, Alpine, Amador, Butte, Calaveras, Colusa, Contra Costa, Del Norte, Eldorado, Fresno, Glenn, Humboldt, Inyo, Kings, Lassen, Madera, Marin, Mariposa, Mendocino, Merced, Modoc, Mono, Monterey, Napa, Nevada, Placer, Plumas, Sacramento, San Benito, San Francisco, San Joaquin, San Mateo, Santa Clara, Santa Cruz, Shasta, Sierra, Siskiyou, Solano, Sonoma, Stanislaus, Sutter, Tulare, Tehama, Trinity, Tuolumne, Yolo, Yuba, and the State of Nevada.

JOSEPH J. SCOTT, San Francisco.

Sixth District.—The counties of Imperial, Kern, Los Angeles, Orange, Riverside, San Bernardino, San Diego, San Luis Obispo, Santa Barbara, and Ventura.

JOHN P. CARTER, Los Angeles.

COLORADO (Including Wyoming), MARK A. SKINNER, Denver.

CONNECTICUT (Includes Rhode Island), JAMES J. WALSH, Hartford.

DELAWARE (See Maryland).

FLORIDA, HENRY HAYES LEWIS, Jacksonville.

GEORGIA, AARON O. BLALOCK, Atlanta.

HAWAII, JOHN F. HALEY, Honolulu.

IDAHO (See Montana).

ILLINOIS.

First District.—The counties of Boone, Carroll, Cook, DeKalb, Dupage, Grundy, Jo Daviess, Kane, Kankakee, Kendall, Lake, Lasalle, Lee, McHenry, Ogle, Stephenson, Whiteside, Will, and Winnebago.

JULIUS F. SMETANKA, Chicago.

Fifth District.—The counties of Bureau, Henderson, Henry, Knox, Marshall, Mercer, Peoria, Putnam, Rock Island, Stark, and Warren.

EDWARD D. McCABE, Peoria.

Eighth District.—The counties of Adams, Bond, Brown, Calhoun, Cass, Champaign, Christian, Coles, Cumberland, Dewitt, Douglas, Edgar, Ford, Fulton, Greene, Hancock, Iroquois, Jersey, Livingston, Logan, McDonough, McLean, Macon, Macoupin, Mason, Menard, Montgomery, Morgan, Moultrie, Piatt, Pike, Sangamon, Schuyler, Scott, Shelby, Tazewell, Vermilion, and Woodford.

JOHN L. PICKERING, Springfield.

Thirteenth District.—The counties of Alexander, Clark, Clay, Clinton, Crawford, Edwards, Effingham, Fayette, Franklin, Gallatin, Hamilton, Hardin, Jackson, Jasper, Jefferson, Johnson, Lawrence, Madison, Marion, Massac, Monroe, Perry, Pope, Pulaski, Randolph, Richland, St. Clair, Saline, Union, Wabash, Washington, Wayne, White, and Williamson.

JOHN M. RAPP, East St. Louis.

INDIANA

Sixth District.—The counties of Adams, Allen, Bartholomew, Benton, Blackford, Brown, Cass, Dearborn, Decatur, Dekalb, Delaware, Elkhart, Fayette, Franklin, Fulton, Grant, Hamilton, Hancock, Hendricks, Henry, Howard, Huntington, Jackson, Jasper, Jay, Jefferson, Jennings, Johnson, Kosciusko, Lagrange, Lake, Laporte, Lawrence, Madison, Marion, Marshall, Miami, Monroe, Morgan, Newton, Noble, Ohio, Porter, Pulaski, Randolph, Ripley, Rush, St. Joseph, Shelby, Starke, Steuben, Switzerland, Tipton, Union, Wabash, Wayne, Wells, White, and Whitley.

PETER J. KRUYER, Indianapolis.

INDIANA (Concluded)

Seventh District.—The counties of Boone, Carroll, Clark, Clay, Clinton, Crawford, Daviess, Dubois, Floyd, Fountain, Gibson, Greene, Harrison, Knox, Martin, Montgomery, Orange, Owen, Parke, Perry, Pike, Posey, Putnam, Scott, Spencer, Sullivan, Tippecanoe, Vanderburg, Vermilion, Vigo, Warren, Warrick, and Washington.

ISAAC R. STROUSE, Terre Haute.

IOWA. LOUIS MURPHY, Dubuque.

KANSAS. WM. H. L. PEPPERELL, Wichita.

KENTUCKY,

Second District.—The counties of Allen, Ballard, Barren, Breckenridge, Butler, Caldwell, Calloway, Carlisle, Christian, Clinton, Crittenden, Cumberland, Daviess, Edmonson, Fulton, Graves, Grayson, Hancock, Hart, Henderson, Hickman, Hopkins, Livingston, Logan, Lyon, McCracken, McLean, Marshall, Metcalfe, Monroe, Muhlenberg, Ohio, Russell, Simpson, Todd, Trigg, Union, Warren, and Webster.

JOSH T. GRIFFITH, Owensboro.

Fifth District.—The city of Louisville and the counties of Adair, Bullitt, Casey, Green, Hardin, Henry, Jefferson, Larue, Marion, Meade, Nelson, Oldham, Owen, Shelby, Spencer, Taylor, and Washington.

THOMAS S. MAYES, Louisville.

Sixth District.—The counties of Boone, Bracken, Campbell, Carroll, Gallatin, Grant, Harrison, Kenton, Pendleton, Robertson, and Trimble.

CHARLTON B. THOMPSON, Covington.

Seventh District.—The counties of Bath, Bourbon, Boyd, Carter, Clark, Elliott, Fayette, Fleming, Franklin, Greenup, Johnson, Lawrence, Lewis, Martin, Mason, Menifee, Montgomery, Morgan, Nicholas, Powell, Rowan, Scott, and Woodford.

BEN MARSHALL, Lexington.

Eighth District.—The counties of Anderson, Bell, Boyle, Breathitt, Clay, Estill, Floyd, Garrard, Harlan, Jackson, Jessamine, Knott, Knox, Laurel, Lee, Leslie, Letcher, Lincoln, Madison, Magoffin, Mercer, McCreary, Owsley, Perry, Pike, Pulaski, Rockcastle, Wayne, Whitley, and Wolfe.

JOHN W. HUGHES, Danville.

LOUISIANA. JOHN Y. FAUNTLEROY, New Orleans.

MAINE (See New Hampshire).

MARYLAND. JOSHUA W. MILES, Baltimore.

District of Maryland consists of the following-named territory: The States of Maryland and Delaware, the District of Columbia, and the counties of Accomac and Northampton of the State of Virginia.

MASSACHUSETTS. JOHN F. MALLEY, Boston.

This district is officially designated as the Third District of Massachusetts.

MICHIGAN,

First District.—Counties of Alcona, Alpena, Arenac, Bay, Branch, Calhoun, Cheboygan, Clare, Clinton, Crawford, Genesee, Gladwin, Gratiot, Hillsdale, Huron, Ingham, Iosco, Isabella, Jackson, Lapeer, Lenawee, Livingston, Macomb, Midland, Monroe, Montmorency, Oakland, Ogemaw, Oscoda, Otsego, Presque Isle, Roscommon, Saginaw, Sanilac, Shiawassee, St. Clair, Tuscola, Washtenaw, and Wayne.

JAMES J. BRADY, Detroit.

Fourth District.—Counties of Alger, Allegan, Antrim, Baraga, Barry, Benzie, Berrien, Cass, Charlevoix, Chippewa, Delta, Dickinson, Eaton, Emmet, Gogebic, Grand Traverse, Houghton, Ionia, Iron, Kalamazoo, Kalkaska, Kent, Keweenaw, Lake, Leelanau, Luce, Mackinac, Manistee, Marquette, Mason, Mecosta, Menominee, Missaukee, Montcalm, Muskegon, Newaygo, Oceana, Ontonagon, Osceola, Ottawa, St. Joseph, Schoolcraft, Van Buren, and Wexford.

EMANUEL J. DOYLE, Grand Rapids.

MINNESOTA. EDWARD J. LYNCH, St. Paul.

MISSISSIPPI (See Alabama).

The State of Mississippi detached from the District of Louisiana and added to the District of Alabama June 1, 1908.

MISSOURI.

First District.—The counties of Adair, Audrian, Bollinger, Boone, Butler, Callaway, Cape Girardeau, Carter, Clark, Crawford, Dent, Dunklin, Franklin, Gasconade, Howard, Iron, Jefferson, Knox, Lewis, Lincoln, Linn, Macon, Madison, Maries, Marion, Mississippi, Montgomery, Monroe, New Madrid, Oregon, Osage, Pemiscot, Perry, Phelps, Pike, Pulaski, Ralls, Randolph, Reynolds, Ripley, St. Charles, St. Francois, Ste. Genevieve, St. Louis, Schuyler, Scotland, Scott, Shannon, Shelby, Stoddard, Warren, Washington, and Wayne.

GEORGE H. MOORE, St. Louis.

Sixth District.—The counties of Andrew, Atchison, Barry, Barton, Bates, Benton, Buchanan, Caldwell, Camden, Carroll, Cass, Cedar, Chariton, Christian, Clay, Clinton, Cole, Cooper, Dade, Dallas, Daviess, Dekalb, Douglas, Gentry, Greene, Grundy, Harrison, Henry, Hickory, Holt, Howell, Jackson, Jasper, Johnson, Laclede, Lafayette, Lawrence, Livingston, McDonald, Mercer, Miller, Moniteau, Morgan, Newton, Nodaway, Ozark, Pettis, Platte, Polk, Putnam, Ray, St. Clair, Saline, Stone, Sullivan, Taney, Texas, Vernon, Webster, Worth, and Wright.

EDGAR M. HARBER, Kansas City.

MONTANA (Includes Utah and Idaho), WILLIAM C. WHALEY, Helena.

NEBRASKA, GEO. L. LOOMIS, Omaha.

NEVADA (See First California).

NEW HAMPSHIRE (Includes Maine and Vermont), SETH W. JONES, Portsmouth.

NEW JERSEY,

First District.—The counties of Atlantic, Burlington, Camden, Cape May, Cumberland, Gloucester, Mercer, Monmouth, Ocean, and Salem.

SAMUEL IREDELL, Camden.

Fifth District.—The counties of Bergen, Essex, Hudson, Hunterdon, Middlesex, Morris, Passaic, Somerset, Sussex, Union, and Warren.

CHARLES V. DUFFY, Newark.

NEW MEXICO (Includes Arizona), LEWIS T. CARPENTER, Phoenix, Arizona.

NEW YORK,

First District.—The counties of Kings, Nassau, Queens, Richmond, and Suffolk.

HENRY P. KEITH, Brooklyn.

Second District.—The first, second, third, fourth, fifth, sixth, eighth, ninth, and fifteenth wards of New York City; that portion of the fourteenth ward lying west of the center of Mott street; that portion of the sixteenth ward lying south of the center of West Twenty-fourth Street, and Governors Island.

JOHN Z. LOWE, Jr., Custom House, New York.

Third District.—The seventh, tenth, eleventh, twelfth, thirteenth, seventeenth, eighteenth, nineteenth, twentieth, twenty-first, and twenty-second wards of New York City; that part of the fourteenth ward lying east of the center of Mott Street; that part of the sixteenth ward lying north of the center of West Twenty-fourth Street, and Blackwells, Randalls, and Wards Islands.

MARK EISNER, 1150 Broadway, New York.

Fourteenth District.—The counties of Albany, Clinton, Columbia, Dutchess, Essex, Fulton, Greene, Hamilton, Montgomery, Orange, Putnam, Rensselaer, Rockland, Saratoga, Schenectady, Schoharie, Sullivan, Ulster, Warren, Washington, and Westchester, and the twenty-third and twenty-fourth wards of New York City.

ROSCOE IRWIN, Albany.

Twenty-first District.—The counties of Broome, Cayuga, Chenango, Cortland, Delaware, Franklin, Herkimer, Jefferson, Lewis, Madison, Oneida, Onondaga, Oswego, Otsego, St. Lawrence, Schuyler, Seneca, Tioga, Tompkins, and Wayne.

NEIL BREWSTER, Syracuse.

Twenty-eighth District.—The counties of Allegany, Cattaraugus, Chautauqua, Chemung, Erie, Genesee, Livingston, Monroe, Niagara, Ontario, Orleans, Steuben, Wyoming, and Yates.

VINCENT H. RIORDAN, Buffalo.

NORTH CAROLINA.

Fourth District.—The counties of Alamance, Beaufort, Bertie, Bladen, Brunswick, Camden, Carteret, Caswell, Chatham, Chowan, Columbus, Craven, Cumberland, Currituck, Dare, Duplin, Durham, Edgecombe, Franklin, Gates, Granville, Greene, Halifax, Harnett, Hertford, Hyde, Johnston, Jones, Lenoir, Martin, Montgomery, Moore, Nash, New Hanover, Northampton, Onslow, Orange, Pamlico, Pasquotank, Pender, Perquimans, Person, Pitt, Richmond, Robeson, Samson, Scotland, Tyrrell, Vance, Wake, Warren, Washington, Wayne, and Wilson.

JOSIAH W. BAILEY, Raleigh.

Fifth District.—The counties of Alexander, Alleghany, Anson, Ashe, Buncombe, Burke, Cabarrus, Caldwell, Catawba, Cherokee, Clay, Davidson, Davie, Forsyth, Gaston, Graham, Guilford, Haywood, Henderson, Iredell, Jackson, Lincoln, McDowell, Macon, Madison, Mecklenburg, Mitchell, Polk, Randolph, Rockingham, Rowan, Rutherford, Stanly, Stokes, Surry, Swain, Transylvania, Union, Watauga, Wilkes, Yadkin, and Yancey.

ALSTON D. WATTS, Statesville.

NORTH AND SOUTH DAKOTA, JAMES COFFEY, Aberdeen, S. Dak. OHIO.

First District.—The counties of Brown, Butler, Clarke, Clermont, Clinton, Fayette, Greene, Hamilton, Highland, Miami, Montgomery, Preble, and Warren.

ANDREW C. GILLIGAN, Cincinnati.

Tenth District.—The counties of Allen, Auglaize, Champaign, Crawford, Darke, Defiance, Erie, Fulton, Hancock, Hardin, Henry, Huron, Logan, Lucas, Mercer, Ottawa, Paulding, Putnam, Sandusky, Seneca, Shelby, Van Wert, Williams, Wood, and Wyandot.

FRANK B. NILES, Toledo.

Eleventh District.—The counties of Adams, Athens, Coshocton, Delaware, Fairfield, Franklin, Gallia, Guernsey, Hocking, Jackson, Knox, Lawrence, Licking, Madison, Marion, Meigs, Morgan, Morrow, Muskingum, Noble, Perry, Pickaway, Pike, Ross, Scioto, Union, Vinton, and Washington.

BERIAHE. WILLIAMSON, Columbus.

Eighteenth District.—The counties of Ashland, Ashtabula, Belmont, Carroll, Columbiana, Cuyahoga, Geauga, Harrison, Holmes, Jefferson, Lake, Larain, Mahoning, Medina, Monroe, Portage, Richland, Stark, Summit, Trumbull, Tuscarawas, and Wayne.

HARRY H. WEISS, Cleveland.

OKLAHOMA, HUBERT L. BOLEN, Oklahoma City.**OREGON, MILTON A. MILLER, Portland.****PENNSYLVANIA.**

First District.—The counties of Berks, Bucks, Chester, Delaware, Lehigh, Montgomery, Philadelphia, and Schuylkill.

EPHRAIM LEDERER, Philadelphia.

Ninth District.—The counties of Adams, Bedford, Blair, Cumberland, Dauphin, Franklin, Fulton, Huntingdon, Juniata, Lancaster, Lebanon, Mifflin, Perry, Snyder, York.

BENJAMIN F. DAVIS, Lancaster.

Twelfth District.—Bradford, Carbon, Center, Clinton, Columbia, Lackawanna, Luzerne, Lycoming, Monroe, Montour, Northampton, Northumberland, Pike, Potter, Sullivan, Susquehanna, Tioga, Union, Wayne, Wyoming. (Twelfth District reestablished May 1, 1915.)

FRED. C. KIRKENDALL, Scranton.

Twenty-third District.—The counties of Allegheny, Armstrong, Beaver, Butler, Cambria, Cameron, Clarion, Clearfield, Crawford, Elk, Erie, Fayette, Forest, Greene, Indiana, Jefferson, Lawrence, McKean, Mercer, Somerset, Venango, Warren, Washington and Westmoreland.

C. GREGG LEWELLYN, Pittsburgh.

RHODE ISLAND (See Connecticut).**SOUTH CAROLINA, DUNCAN C. HEYWARD, Columbia.****SOUTH DAKOTA (See North and South Dakota).****TENNESSEE, EDWARD B. CRAIG, Nashville.****TEXAS, ALEXANDER S. WALKER, Austin.****UTAH (See Montana).****VERMONT (See New Hampshire).**

VIRGINIA

Second District.—The counties of Amelia, Appomattox, Brunswick, Buckingham, Caroline, Charles City, Chesterfield, Cumberland, Dinwiddie, Elizabeth City, Essex, Fluvanna, Gloucester, Goochland, Greensville, Hanover, Henrico, Isle of Wight, James City, King and Queen, King George, King William, Lancaster, Louisa, Lunenburg, Mathews, Middlesex, Nansemond, New Kent, Norfolk, Northumberland, Nottaway, Powhatan, Prince Edward, Prince George, Princess Anne, Richmond, Stafford, Southampton, Spottsylvania, Surry, Sussex, Warwick, Westmoreland, and York.

RICHARD C. L. MONCURE, Richmond.

Sixth District.—The counties of Albemarle, Alexandria, Alleghany, Amherst, Augusta, Bath, Bedford, Bland, Botetourt, Buchanan, Campbell, Carroll, Charlotte, Clarke, Craig, Culpeper, Dickenson, Fairfax, Fauquier, Floyd, Franklin, Frederick, Giles, Grayson, Greene, Halifax, Henry, Highland, Lee, Loudoun, Madison, Mecklenburg, Montgomery, Nelson, Orange, Page, Patrick, Pittsylvania, Prince William, Pulaski, Rappahannock, Roanoke, Rockbridge, Rockingham, Russell, Scott, Shenandoah, Smyth, Tazewell, Warren, Washington, Wise, and Wythe.

JOHN M. HART, Roanoke.

The counties of Accomac and Northampton are in the District of Maryland.

WASHINGTON (Includes Alaska), DAVID J. WILLIAMS, Tacoma.

WEST VIRGINIA, SAMUEL A. HAYS, Parkersburg.

WISCONSIN

First District.—Counties of Brown, Calumet, Dodge, Door, Florence, Fond du Lac, Forest, Green Lake, Kenosha, Kewaunee, Manitowoc, Marinette, Marquette, Milwaukee, Oconto, Outagamie, Ozaukee, Racine, Shawano, Sheboygan, Walworth, Washington, Waukesha, Waupaca, Waushara, Winnebago, and county of Langlade with exception of the eight townships of said county which were formerly in Lincoln County.

PAUL A. HEMMY, Milwaukee.

Second District.—Counties of Adams, Ashland, Barron, Bayfield, Buffalo, Burnett, Chippewa, Clark, Columbia, Crawford, Dane, Douglas, Dunn, Eau Claire, Grant, Green, Iowa, Iron, Jackson, Jefferson, Juneau, La Crosse, Lafayette, Lincoln, Marathon, Monroe, Oneida, Pepin, Pierce, Polk, Portage, Price, Richland, Rock, Rusk, St. Croix, Sauk, Sawyer, Taylor, Trempealeau, Vernon, Vilas, Washburn, Wood, and the eight townships in the western part of Langlade County which were formerly in Lincoln County.

BURT WILLIAMS, Madison.

WYOMING (See Colorado).

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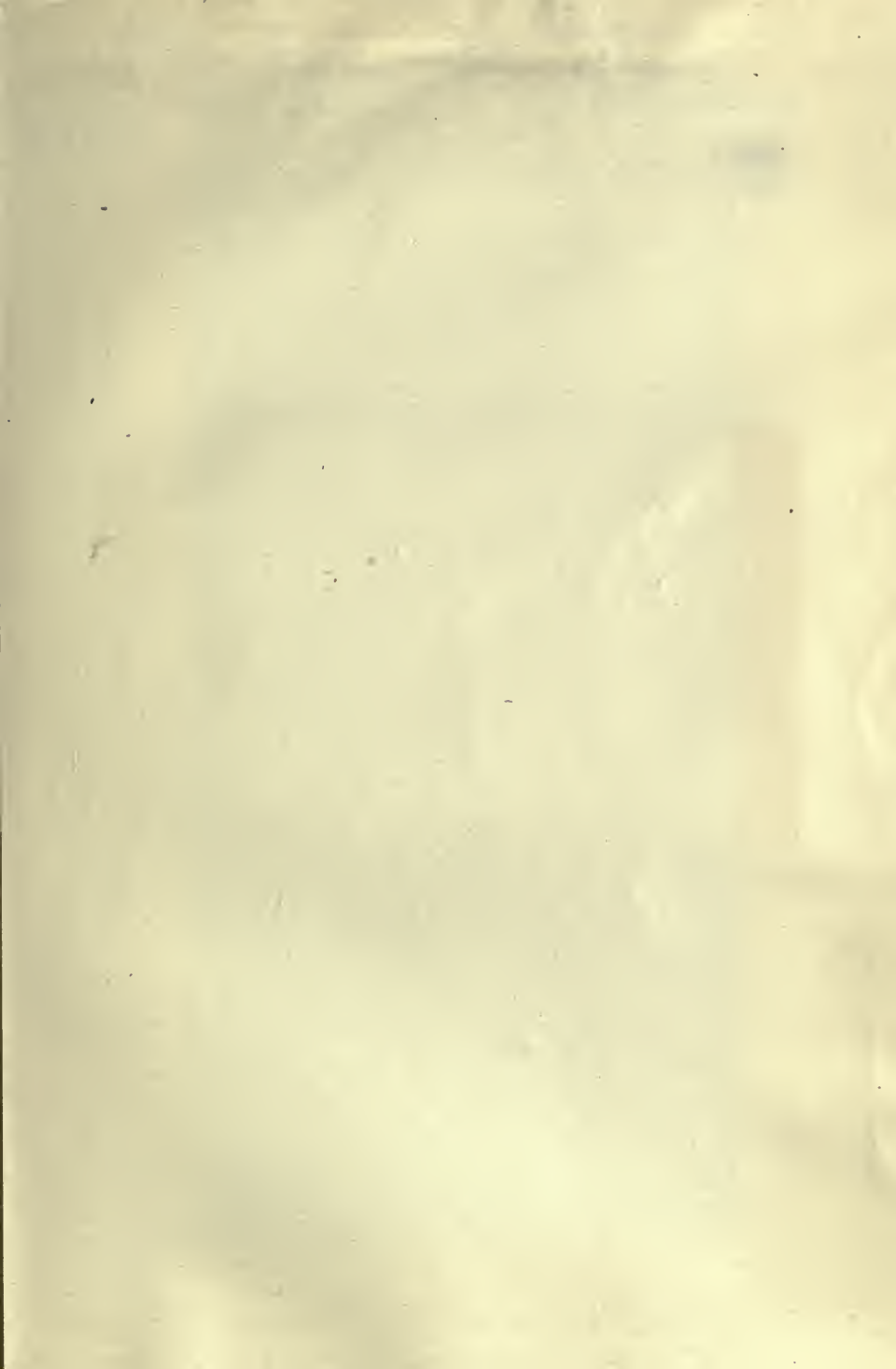
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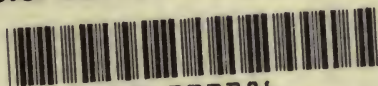
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